Report of the
Comptroller and Auditor General
of India

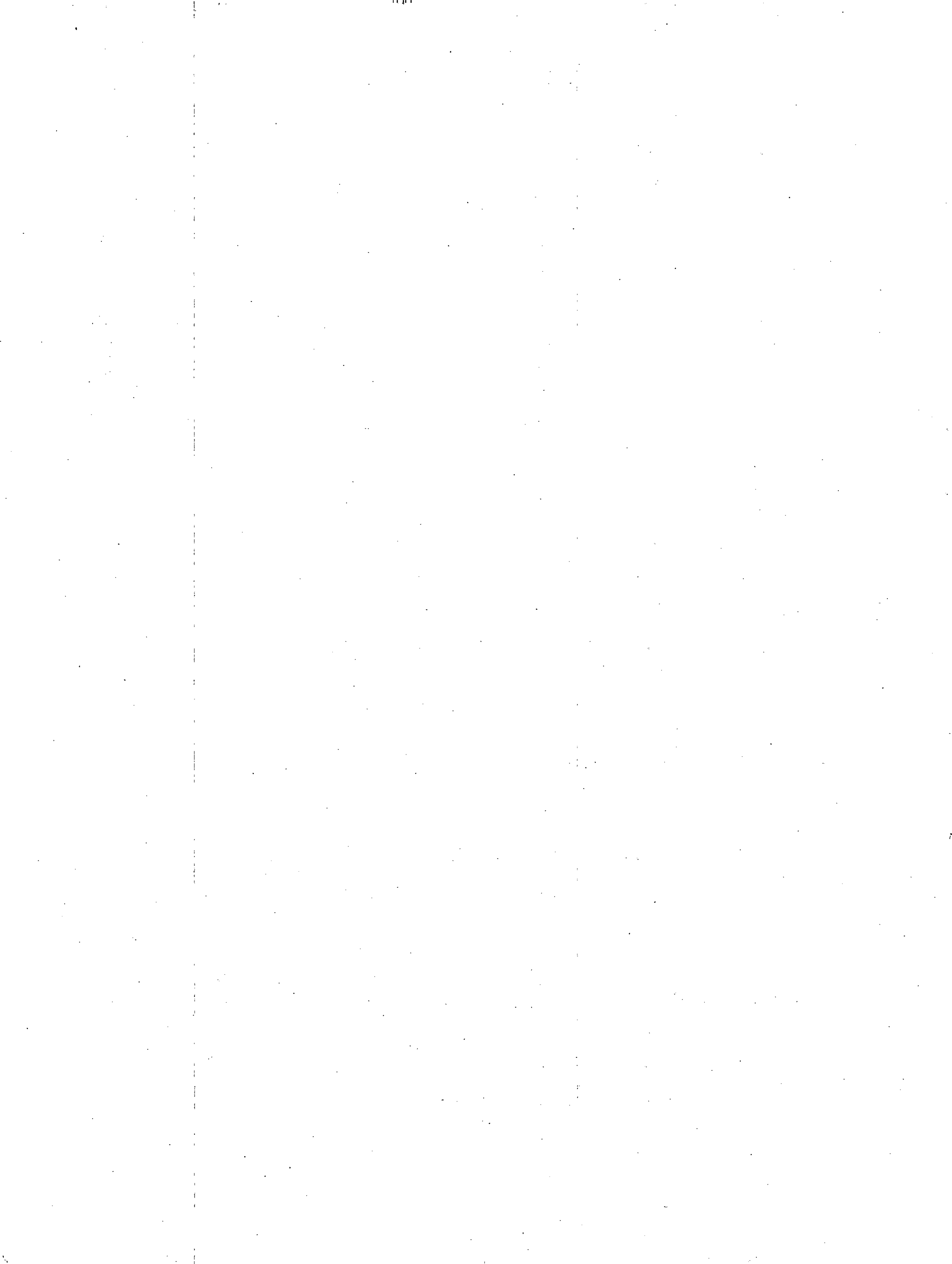
for the year ended March 2004

Union Government (Commercial)

Public Sector Undertakings

Reviews on some of the activities of selected PSUs

No. 4 of 2005



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PREFACE

A reference is invited to the prefatory remarks in Report of the Comptroller and Auditor General of India – Union Government No.1 (Commercial) 2005 where a mention was made that reviews on the performance of Companies/Corporations by the Comptroller and Auditor General of India are presented in separate Reports.

This Report contains the reviews on some of the activities of the following PSUs:

Name of the Ministry/Department	Title of the Review
Ministry of Chemicals and Fertilizers, Department of Chemicals and Petro-chemicals	Manpower Analysis in Hindustan Organic Chemicals Limited
Ministry of Civil Aviation	Review of Regional Office of Air India at New York
Ministry of Coal	(a) Performance of Madhuband Washery of Bharat Coking Coal Limited (b) IT Review on Asset Management system in Western Coalfields Limited
Ministry of Consumer Affairs, Food and Public Distribution	Export of foodgrains by Food Corporation of India
Department of Defence Production and Supplies	(a) Project implementation, production planning, marketing activities and internal control in Bharat Electronics Limited (b) IT Review on Inventory management at Bangalore Complex of Bharat Electronics Limited (c) Shipbuilding Activities of Garden Reach Shipbuilders and Engineers Limited (d) IT Review on computerization of integrated material management system – Hindustan Aeronautics limited
Ministry of Finance, Department of Economic Affairs (Insurance Division)	Special category Insurance Policies to cover risk of Mobile handsets by Insurance Companies

Ministry of Heavy Industry and Public Enterprises	Implementation of turnaround plan of HMT Limited
Ministry of Shipping	Dredge Repairs of Dredging Corporation of India Limited
Ministry of Small Scale Industries and Agro & Rural Industries	Loan Assistance and Recovery Performance in National Small Industries Corporation Limited
Ministry of Textiles	Sale of surplus land and building in National Textile Corporation (APPK&M) Limited

OVERVIEW

This volume of Audit Report represents reviews on 14 thematic areas of operation involving 13 Public Sector Undertakings under ten Ministries. These themes were selected in audit for review on the basis of their relative importance in the functioning of concerned organisation. The total financial implication of these reviews is Rs.5720.57 crore.

MINISTRY OF CHEMICALS AND FERTILIZERS
DEPARTMENT OF CHEMICALS AND PETROCHEMICALS

Hindustan Organic Chemicals Limited

❖ **Manpower Analysis**

- The review of manpower analysis of the Company revealed that high incidence of expenditure on employee cost over and above the industry norms in Rasayani unit and non-implementation of voluntary retirement scheme (VRS) after April 2002 due to financial constraints impinged heavily on the economic running of the plants. Besides this, due to the absence of data relating to plant-wise recruitment of manpower and their deployment, effective utilisation of the manpower could not be ensured.
- The Company suffered a total loss of Rs.459.19 crore in the operation of the Rasayani unit during the last five years upto 2003-04 mainly on account of old technology and high cost of manpower in comparison to industry norms.
- The Company had not reviewed plant-wise requirement of manpower and its effective utilisation after the closure of seven plants of Rasayani unit during 1999-2003.
- The delay in implementing the rolling back of retirement age from 60 years to 58 years after its clearance by the Board in August 1999 resulted in additional outgo of Rs.59.92 lakh.
- The Company could not derive the benefit of annual savings to the extent of Rs.77 lakh pending acceptance of VRS applications received from 33 employees in April 2002 for want of financial assistance amounting to Rs.3.26 crore from the Government of India.
- The Company identified (April 2004) surplus man-power to the extent of 500 employees in Rasayani unit on whom it was incurring recurring expenditure of Rs.14 crore per annum. However, the final decision to reduce it was still awaited (October 2004).

- Due to failure to formulate any suitable VRS for certain categories of workers like Mathadi, Society and Canteen workers, the Company had to pay idle wages to the extent of Rs.3.21 crore during the last three years.

- Against the industry's norm of six to seven per cent of manpower cost to sales realisation, the manpower cost in Rasayani unit ranged between 24 and 40 per cent during the period from 1999-2000 to 2003-04 resulting in an extra expenditure of Rs.126.98 crore.

- The Company's failure to exercise proper control over the appointment of staff through its representatives in the Advisory committee of the management of the Hindustan Organic Chemical school in earlier years resulted in an avoidable expenditure of Rs.1.53 crore during March 2001 to December 2003.

MINISTRY OF CIVIL AVIATION

Air India Limited

❖ **Inadequate Expenditure Control in Regional Office of Air India at New York**

Air India's Regional office at New York incurred an avoidable expenditure aggregating to Rs.5.74 crore on account of delay in award of contract for security service and consequent increase in rates, non-maintenance of records for ascertaining the time devoted by security personnel provided by the contractor, failure to secure discounts/incentives available under contract for catering, hiring of transport services for crew/passengers at uncompetitive rates and excessive lay over period provided to cabin attendants at New York. This included the extra expenditure of Rs.4.74 crore, in respect of hiring of the transport services and the excessive lay over period, which was of recurring nature every year. Further, non-maintenance of adequate accounts at the Regional Office led to uncontrolled accumulation of debtors and the risk of omitting non-cash transactions in the financial statements.

MINISTRY OF COAL

Bharat Coking Coal Limited

❖ **Madhuband Coal Washery**

- The construction of Madhuband Coal Washery was awarded to Mining and Allied Machinery Corporation Limited in December 1985 at a cost of Rs.72.50 crore as against the lowest bid of Rs.54.35 crore. A review by Audit revealed that the Company had failed to attain the objective of production and supply of washed coking coal to the steel plants in order to narrow the gap between the demand and supply of washed coal from indigenous sources. Several causes for delay in setting-up of the washery at the total capital investment of Rs 197.23 crore inclusive of substantial cost-overrun, lack of adequate feasibility study, improper selection of the contractor and poor performance of linked mine were noticed.

- The washery was put to operation in incomplete shape without addressing the deficiencies and bypassing some of its production circuit. This led to gross under-utilisation of capacity and the uneconomical operation. The washery sustained a loss of Rs.127.03 crore over last five years of its operation ending 31 March 2004.

- In view of failure to arrange raw coking coal for feeding to the washery, a decision was taken to convert the washery for washing non-coking coal for supply of 'washed power coal' to powerhouses instead of coking coal for which it was designed. The decision frustrated the basic purpose for which it was constructed.

Western Coalfields Limited

❖ **IT Review on Asset Management System**

The Asset Accounting System in the Western Coalfields Limited served the limited purpose of calculation of depreciation and generation of asset register. It was not a complete system in itself and was not linked to the Financial Accounting System. It was running in different languages at different units with end-users having unlimited authority to effect changes in module and alter entries in asset register. Further, no built-in checks were developed in the system to ensure data integrity and compliance of accounting principles.

MINISTRY OF CONSUMER AFFAIRS, FOOD AND PUBLIC DISTRIBUTION

Food Corporation of India

❖ **Export of foodgrains**

The Government of India (GOI) permitted the Food Corporation of India (FCI) to offer wheat and rice for export due to heavy accumulation of stocks in central pool. This was due to increased procurement neither justified from the production point of view nor from off-take. FCI issued 33.24 million MT of wheat and rice for export during the period from November 2000 to February 2004.

- The fixation of lower export price for wheat due to adoption of lower economic cost and higher carrying cost resulted in additional subsidy burden of Rs.1608.63 crore.

- The exporters were allowed pick and choose policy in lifting the stocks of wheat and rice leading to unwarranted inland movement of foodgrains involving heavy freight charges at the cost of FCI. The freight charges incurred in 22 districts test checked in Audit worked out to Rs. 516.36 crore.

- The high incidence of freight charges on inland movement also had the effect of reducing the net realization from exports which fell below the BPL rate.

- The FCI reimbursed transportation charges of Rs.105.27 crore without obtaining the prescribed documents as directed by the Ministry.
- The exporters to Bangladesh were given an unintended benefit of Rs.44.25 crore in transportation of foodgrains by rail.
- The exporters were given undue benefit of Rs.20.20 crore by allowing them to lift the foodgrains after price revision.
- There were many deficiencies in export operations, besides non-compliance of instructions of the Ministry such as reimbursement of road transportation charges without proper proof of payment, giving allowances when not required, extending undue benefit to exporters, issue of foodgrains at pre-revised rates after price revision etc. There were also instances of irregularities, that is, non-recovery of penalties, non-submission of export documents, doubtful cases of exports and non-existence of adequate internal control mechanism.

DEPARTMENT OF DEFENCE PRODUCTION AND SUPPLIES

Bharat Electronics Limited

❖ **Project Implementation, Production Planning, Marketing Activities and Internal Controls**

- The Company's investment of Rs.27.40 crore in seven projects was largely idle/unproductive due to preparation of unrealistic feasibility reports, under utilisation of capacity due to unwarranted expansion, non-receipt of anticipated orders, inability to capture market and non safeguarding of its interests.
- The Company could not achieve its objective of self-reliance through indigenisation as it continued to import 73 per cent of the raw materials and components.
- The Company could not withstand the competition in non-defence sector resultantly its sales (non-defence sales to total sales) decreased from 26.06 per cent in 1999-00 to 22.85 per cent in 2003-04. It also incurred loss of Rs.8.57 crore in taking up four products meant for civilian sector.
- There was delay in raising sales invoices from 12 to 424 days resulting in loss of interest of Rs.3.93 crore.
- The Company's existing internal control procedures were not adequate to keep pace with increasing business activities and change in technology.

Bharat Electronics Limited

❖ **Information Technology Audit on the computerisation of inventory management at Bangalore Complex**

- The primary objective of implementation of Integrated Information System with particular emphasis on scalability and upgradeability was not achieved.

- Discrepancies to the tune of Rs.67.75 crore existed in the comparable data between Manufacturing Resource Planning System-II (MRP-II) and Integrated Finance Accounting System (IFAS); 350 items valued at Rs.26.07 crore appearing in IFAS did not appear in MRP-II.

- Alteration of financial data in IFAS for reversal of sale of Rs.29.78 crore was done but no alterations took place with stock position.

- The criterion adopted by the system for fast, slow and non-moving inventories analysis was flawed and consequently material worth Rs.2.16 crore which had not moved for one to two years was identified as fast-moving in one of the divisions.

- Right of access had been given to employees without analysis of minimum access requirement.

Garden Reach Shipbuilders and Engineers Limited

❖ **Shipbuilding Activities**

- The Government of India acquired the erstwhile Joint Stock Company under the name and style of Garden Reach Shipbuilders and Engineers Limited (GRSE) in April 1960 to cater to the defence requirements relating to shipbuilding and ship repair. The company has three functional divisions namely ship division, engineering division and engine division. Of these, ship division carries out the main activity of shipbuilding.

- Shipbuilding is essentially a manufacturing-cum-assembly industry and the capacity of shipbuilding should be judged taking into account all aspects of ship construction. It should be measured in terms of a single parameter like "Standard Ship Unit" (SSU). Though other Companies involved in shipbuilding activities under the Ministry of Defence have adopted this parameter, GRSE has, in spite of being in operation for the last 44 years, failed to measure its capacity in terms of SSU.

- While the Company has been earning profits, this has been essentially on account of 'cost plus' contracts where the customer ensures a margin over the actual cost.

- Of the vessels delivered by the Company in the last six years, there was a time overrun ranging from one to 125 months. There was a cost overrun of Rs.1669.88 crore in the construction of 15 ships. In addition, the Company has

incurred liquidated damages amounting to Rs.7.35 crore due to delays that occurred on the part of the Company.

- The Company incurred an avoidable expenditure of Rs.14.28 crore on salary and wages for idle mandays .

Hindustan Aeronautics Limited

❖ **Information Technology Audit on computerisation of integrated material management system**

- The Local Area Network (LAN)/Wide Area Network (WAN) established in March 2003 in three Divisions of the Company at a cost of Rs.2.53 crore were not being utilised optimally due to non-compatibility with Central Network Server Systems.
- There was absence of a well laid down password policy and logical access control mechanism rendering the system vulnerable to abuse besides making it difficult to fix responsibility in case of manipulation/ corruption of the database.
- Various deficiencies in application control resulting in incomplete, inaccurate and unreliable data were observed for want of required level of input controls, absence of validation checks/constraints at data entry level, duplication of work without compensating controls, duplicate material codes, duplicate part numbers, error in programme logic, non-inclusion of key fields, numerous manual interventions and non-devising of monitoring system.
- Helicopter Division charged off a sum of Rs.22.64 crore to consumption and cost of sales on an adhoc basis through a dummy work order.
- There were negative balances in the material ledger due to deficiencies in system logic/applications; as such adjustments had to be carried out for Rs.51.38 crore and Rs.67.47 crore in 2002-03 and 2003-04 respectively.
- The Company had not formulated any IT Policy.

DEPARTMENT OF ECONOMIC AFFAIRS-INSURANCE DIVISION

National Insurance Company Limited
Oriental Insurance Company Limited

❖ **Special Category Insurance Policies to cover risk of Mobile handsets by Insurance Companies**

- The review of Special Contingency Policies (SCPs) on mobile handsets revealed that the National Insurance Company Limited (NIC) and the Oriental Insurance

Company Limited had underwritten the risks associated with mobile handsets without careful evaluation of the risk factor involved and other technical aspects, which resulted in heavy losses to these companies. An analysis by audit revealed that SCPs issued were devised primarily to suit the requirements of the insured, without safeguarding the insurers' interest owing to non-adoption of the prudent underwriting guidelines.

The failure on the part of the management to obtain reinsurance protection, ensure the compliance of IRDA/GIPSA guidelines as well as non-inclusion of the loading clause deprived the Company of the opportunity to reduce its losses in all the SCPs issued during 2002-03 to 2004-05 which resulted in huge loss amounting to 142.63 crore (NIC Rs.126.58 crore and OIC Rs.16.05 crore) and made GIC suffer loss amounting to Rs.41.37 crore.

The system of internal control which existed in the Company was inadequate and needed to be strengthened.

MINISTRY OF HEAVY INDUSTRY AND PUBLIC ENTERPRISES

HMT Limited

❖ **Mid term Review on Turnaround Plan**

- Turnaround Plan conceived only the reorganisation of the business and did not attempt turning around the fortunes of the ailing Company. Thus, the failure of the Turnaround Plan was mainly due to unrealistic and overly optimistic projections with insufficient financial support which both the Company and Government of India were well aware of. The projections in the Turnaround Plan were not supported by actual trends preceding the period covered in the Turnaround Plan and concrete action plan to achieve them. An unwritten objective of the entire subsidiarisation process was to avoid a reference to the Board for Industrial and Financial Reconstruction.

- Even though the Company agreed in the Memorandum of Understanding not to seek further financial assistance/concessions from the Government of India, the Company obtained loans amounting to Rs.190.02 crore till October 2004 for settlement of Voluntary Retirement Scheme payments and Rs.87.38 crore for payment of arrears of salaries and wages of the subsidiaries upto July 2004.

- Ministry has not given due importance to the implementation of the Turnaround Plan in the Company. The posts of important functional Directors of HMT Limited and other Directors of the Subsidiaries were kept vacant during the crucial period of implementation of the Turnaround Plan.

- Various Committees constituted in the Company, either specifically to oversee the implementation of the Turnaround Plan or monitor the performance of the Company in the normal course of business, were not effective.

MINISTRY OF SHIPPING

Dredging Corporation of India Limited

❖ *Dredge Repairs*

- The Company incurred Rs.374.42 crore during 1999-00 to 2003-04 on repairs and maintenance of its dredgers, which constituted 34 per cent of the total operating expenditure.
- Delay in dry-docking beyond the prescribed period of 18 months led to decline in production of 35.58 lakh M^3 in six cases.
- Delays in obtaining statutory clearances led to idling of the dredgers and increased repair time resulting in loss of revenue of Rs.7.12 crore.
- There were cost overruns involving an additional expenditure of Rs.13.13 crore in nine dry-docks and time over runs in 13 cases involving a loss of revenue of Rs.14.40 crore after adjusting Rs.9.30 crore recovered towards liquidated damages from the repair firms.
- The company lacked ability to prepare cost estimates for dry-dock package in house though it was in the business for the last 28 years.
- Incorrect evaluation of tenders resulted in ignoring the lowest offers of PSU shipyards in two cases and in one case the Company cancelled the global tender and sought a fresh quotation on nomination basis which resulted in a total loss of revenue of Rs. 3.19 crore.
- Non-invoking the provisions of the security clause in the contract against premature failures of repairs resulted in the Company absorbing the entire repair cost besides incurring a revenue loss of Rs.4.41 crore in one case.
- The Company allowed vessels to sail without first ascertaining the availability of dry-dock slots. This led to idling of the dredgers and avoidable expenditure on voyage and loss of time and revenue of Rs.1.72 crore in two cases.
- Although the Company spent Rs.185.13 crore on spares and stores during 1999-00 to 2003-04, it did not have proper system of inventory controls.
- Value of stores and spares on board the dredgers was not accounted for as inventory. The Company continued to dispatch materials to dredgers without ascertaining consumption. This led to substantial accumulation of inventory on board, which stood at Rs.77.08 crore as of March 2004.

MINISTRY OF SMALL INDUSTRIES & AGRO & RURAL INDUSTRIES

National Small Industries Corporation Limited

❖ **Loan assistance and Recovery Performance**

- The Company was incorporated in February 1955 to provide financial assistance to small industrial units for industrial development of the country. However, due to the deficiencies in pre-sanction appraisals and weak recovery mechanism a very large percentage of its debts have become bad and doubtful. Accumulated losses as on 31 March 2004 stood at Rs.143.52 crore.

- Recovery performance being poor, the Company had to avail a loan of Rs.70 crore from Small Industries Development Bank of India leading to payment of interest of Rs.22.95 crore during the period 1998-99 to 2003-04, which could have been avoided.

- Due to poor recovery performance, the Non Performing Assets (NPA) stood at Rs.184.97 crore (86 percent) of the total outstanding loan of Rs.215.56 crore as on 31 March 2004.

- In 24 cases test checked in audit, deficiencies were noticed in appraisal, sanction and follow up which led to non-recovery of Rs.18.61 crore.

- 2053 civil suits/petitions for recovery of Rs.181.66 crore are pending in various courts. The Company could not execute decrees in 816 cases involving Rs.36.51 crore due to ineffective follow up. Further in 12 cases chances of recovery of Rs.37.34 crore are remote.

- The Company lost Rs.1.89 crore due to failure in monitoring the disposal of seized machinery.

MINISTRY OF TEXTILES

National Textiles Corporation (APKK&M) Limited

❖ **Sale of Surplus land and building**

- By not considering latest index formula of Income Tax department, government guidance rates and by applying unjustified deductions for various charges the Company worked out the reserve price as Rs.173.70 crore instead of Rs.279.89 crore as worked out in Audit. This resulted in lower fixation of reserve price by Rs.106.19 crore.

- According to the guidelines issued (August 2002) by National Textile Corporation Limited (Holding Company), reserve price was to be fixed at the highest of

Registration, Central Board of Direct Taxes, Central Public Works Department's or Registered Valuers' valuation. However, the Holding Company revised (December 2002) the method of computation of reserve price to average of the three valuations. This resulted in fixation of lower reserve price by Rs.199.56 crore. On this being pointed out in Audit, the Holding Company again changed the method of computation to highest valuation of the valuers.

- Due to fixation of lower reserve price, one party managed to purchase 18.69 acres of land of Mysore Mills on single bid basis for Rs.79.16 crore only, which was even below the Government guidance value as admitted by the purchaser himself. This resulted in loss of Rs.67.65 crore to the Company.

- In respect of Minerva Mills and Netha Mills the Company had foregone a potential revenue realisation of Rs.23.26 crore and Rs.5.50 crore respectively due to fixation of lower reserve price.

- Non-consideration of remunerative offer from Karnataka Housing Board, Bangalore, resulted in foregoing of opportunity to sell the surplus land for a higher consideration to the extent of Rs.55.61 crore.

MINISTRY OF CHEMICALS AND FERTILIZERS
DEPARTMENT OF CHEMICALS AND PETROCHEMICALS

CHAPTER : I

Hindustan Organic Chemicals Limited

Manpower Analysis

Highlights

The Company had suffered a total loss of Rs.459.19 crore in the operation of the Rasayani unit during the last five years up to 2003-04 mainly on account of old technology and high cost of manpower in comparison to industry norm.

(Para 1.3)

The Company due to uneconomic operations, marketing and other problems closed the operations of seven plants of the Rasayani unit from 1999 to 2003. The Company had not reviewed plant-wise requirement of manpower and their effective utilisation after the closure of seven plants.

(Para 1.4.1)

The delay in implementing the rolling back of retirement age from 60 years to 58 years after its clearance by the Board in August 1999 resulted in additional outgo of Rs.59.92 lakh.

(Para 1.4.2)

The Company could not derive the benefit of annual savings to the extent of Rs.77 lakh pending acceptance of voluntary retirement scheme (VRS) applications received from 33 employees in April 2002 for want of financial assistance amounting to Rs.3.26 crore from the Government of India.

(Para 1.4.3)

The Company identified (April 2004) surplus manpower to the extent of 500 employees in Rasayani on which it had been incurring recurring expenditure of Rs.14 crore per annum, however, the final decision to reduce the surplus manpower so as to minimise the cost of labour for improving the profitability was still awaited (October 2004).

(Para 1.4.5)

The value addition per employee, which was Rs.1.66 lakh in 1999-2000, had come down to Rs.1.27 lakh in 2003-04 in-spite of the need to control increased cost of labour and overheads.

(Para 1.4.6)

Due to non-formulating of any suitable VRS for certain categories of workers like Mathadi, Society and Canteen workers, the Company had to pay idle wages to the extent of Rs.3.21 crore during the last three years.

(Para 1.4.8)

Against the industry's norm of about six to seven per cent of manpower cost to sales realisation, the percentage of manpower cost in Rasayani unit ranged between 24 and 40 percent resulting in an extra expenditure of Rs.126.98 crore.

(Para 1.4.9)

The increase in variable and fixed costs in Rasayani unit during the period from 2001-02 to 2003-04 resulted in substantial increase in operating loss from Rs.17.47 crore in the year 2001-02 to Rs.28.68 crore in the year 2003-04.

(Para 1.4.9)

The payment of Productivity Linked Incentive (PLI) amounting to Rs.50.54 lakh for the year 2001-02 and 2002-03 made in October 2003 was in violation of the scheme approved by the Board of Directors / DPE guidelines.

(Para 1.5.1)

The Company's failure to exercise proper control over the appointment of staff through the Company's representatives in the Advisory committee of the management of the school in the earlier years resulted in an avoidable expenditure of Rs.1.53 crore during March 2001 to December 2003.

(Para 1.5.2)

1.1 Introduction

Hindustan Organic Chemicals Limited (HOCL) was incorporated in December 1960 with the main objective of manufacturing, buying, selling and dealing in several organic and inorganic chemicals for the pharmaceuticals, fertilizers, rubber processing chemicals and other allied industries. The Company has two manufacturing units located at Rasayani (Maharashtra) and Cochin (Kerala). The Rasayani unit produces various chemicals viz. aniline, nitrobenzene, hydrogen, acetanilide, formaldehyde, monochlorobenzene, nitrochlorobenzene, nitrotoluene, concentrated nitric acid and sulphuric acid and Cochin unit produces phenol, acetone and hydrogen peroxide, which are essential for industries like drugs and pharmaceuticals, dyes and dye-intermediates, rubber, chemicals, laminates and solvent industries.

1.2 Scope

The review aimed at evaluation of the economy, efficiency and effectiveness of the manpower and its impact on the profitability of the Company. The present review covers the manpower employed in Rasayani unit of the Company for the period from 1999-2000 to 2003-04.

1.3 Working Results

The working results of the Company for the last five years upto 31 March 2004 along with unit-wise performance are indicated in the Annexure - 1.

Review of performance of the Company indicated the following position:

(i) Unit-wise performance indicated that there was a total loss of Rs.459.19 crore in the operation of the Rasayani unit, which eroded the profit of Rs.77.75 crore earned from the Cochin unit during the last five years upto 2003-04. This loss

was despite the fact that there was increase in production from 83,398 MTs in 2000-01 to 1,32,099 MTs in 2003-04.

(ii) The efforts of the Company in the last decade to diversify into new products/projects did not yield the expected results due to faulty project formulations in Caustic soda chlorine, Monochlorobenzene, Poly Urethane System Houses, Jawaharlal Nehru Port Trust Tank Farm Project and Methylene Di-phenyl Di-isocyanate project. In fact, the negative returns on these investments were threatening the survival of the Company. With the liberalisation of the economy, the Company was unable to compete with private sector units, which had the benefit of lower manpower cost, and other overheads as discussed in the succeeding paragraphs.

(iii) As the accumulated loss as on 31 March 2003 had eroded more than 50 per cent of its networth, a reference was made to BIFR as required under the Sick Industrial Companies (Special Provisions) Act, 1985. The decision of BIFR was awaited (October 2004). The Company was beset with problems of idle investment, underutilized capacity, high cost of production, high interest burden on market borrowings, wide product portfolio and idle labour.

1.4 Manpower analysis

The Rasayani unit started making loss from the year 1993-94 due to old technology and high cost of manpower as compared to industry norms. The details of manpower employed in the Rasayani unit and other relevant details during the five years ended 31 March 2004 were as under:

Sl. No.	Particulars	1999-2000	2000-01	2001-02	2002-03	2003-04
1.	Average number of employees	1679	1630	1106	1098	1089
2.	Total employee cost:					
	(a) Salary & wages	30.99	27.85	27.84	24.73	25.54
	(b) Staff welfare expenses.	6.08	5.01	5.27	6.06	6.51
	(c) Total (Rs. in crore)	37.07	32.86	33.11	30.79	32.05
3.	Per employee cost (Rs. in lakh)	2.21	2.02	2.99	2.80	2.94
4	Total production (in MTs)	183522	83398	96158	124604	132099
5.	Value of production (Rs. in crore)	142.67	80.61	89.85	117.26	125.29
6.	Value added (Sales realisation less raw materials & utilities (Rs. in crore)	27.89	13.61	24.01	22.16	13.85

7	Value added per employee (Rs. in lakh)	1.66	0.83	2.17	2.02	1.27
8	Percentage of value added to value of production	20	17	27	19	11
9	Overtime wages paid (Rs. in lakh)	149.53	31.64	18.29	36.79	35.75
10	Overtime hours	190769	47756	29030	34493	31356
11	Employee cost @ seven per cent of value of production (Rs. in crore)	9.99	5.64	6.29	8.21	8.77
12	Extra expenditure on employee cost with reference to industrial norms (column 2(c) – 11)	27.08	27.22	26.82	22.58	23.28

The review of manpower employed in the Rasayani unit revealed the following:

1.4.1 Retention of surplus manpower

The Company closed seven plants of the Rasayani unit due to uneconomic operations, marketing and other problems during the period from 1999 to 2003, rendering the manpower engaged in these plants, surplus. The Company did not review plant-wise availability of manpower and its effective deployment after closure of these seven plants. In the absence of data relating to plant-wise recruitment of manpower and its actual deployment, effectiveness in the utilisation of manpower could not be ensured.

1.4.2 Delay in rolling back of retirement age

Keeping in view the Department of Public Enterprises (DPE) notification dated 19 May 1998 raising retirement age of employees to 60 years, the Board in its meeting held in May 1998 extended the retirement age of employees from 58 years to 60 years. Considering the financial position and to bring down the manpower cost to industry norms, the Board approved (August 1999) the rolling back of retirement age from 60 years to 58 years. The Management forwarded the above proposal in January 2000 to the Ministry for approval, which was approved by the Ministry on 9 February 2001. Thus, there was delay of one year and four months in the implementation of rolling back of retirement age after its approval by the Board. This resulted in additional outgo of Rs.59.92 lakh towards pay plus dearness allowance for 14 months (excluding two months for complying with the procedural requirements).

1.4.3 Incomplete implementation of VRS

All the 118 and 55 employees who had opted for voluntary retirement scheme (VRS)-I & II in operation during the period from January 1999 to April 1999 and from August/1999 to October 1999, respectively, were relieved of their duties and responsibilities after payment of the necessary compensation.

However, in VRS-2001, which was in operation during the period from 8 March 2001 to 23 March 2001 the Company relieved 512 employees out of 522 employees who opted for VRS.

Under VRS-2002, VRS notified in 2001 was reintroduced and was kept open from 25 March 2002 to 10 April 2002 and the operation of the scheme was further extended upto 30 April 2002. The 33 applications (i.e.27 from the Rasayani unit and six from the Cochin unit) received under VRS-2002 were kept pending for want of financial assistance amounting to Rs.3.26 crore from the Government of India. Consequently, the Company could not derive the benefit of saving of Rs.77 lakh per annum.

1.4.4 No scheme for deployment of surplus manpower

The Company identified surplus manpower in October 2002 to the extent of 184 (i.e. 38 in officer's cadre and 146 in non-officer's cadre) through a committee constituted for the purpose in the Rasayani unit. The committee recommended that surplus manpower be utilised for specific purpose till separated through VRS. However, no specific proposal for the deployment of these 184 surplus employees was available in the records made available for audit.

1.4.5 Recurring expenditure on non-productive employees

The review of the Audit Committee report on the working of the Company revealed that the Company was still carrying the burden of 500 non-productive employees on whom it had been incurring recurring expenditure of Rs.14 crore per annum in the Rasayani unit despite three rounds of VRS. The Audit Committee submitted its report to the Board in its meeting held on 15 July 2004. A decision to reduce the surplus man-power so as to minimise the cost of labour for improving profitability, was still awaited (October 2004).

1.4.6 No system for monitoring idle labour time

There were reduced sales realisation due to tough competition from domestic as well as international market, but the Company did not evolve any suitable system/procedure to effectively monitor the deployment of manpower so as to identify the surplus manpower in time for taking prompt remedial action. In the absence of any system to analyse and report the impact of manpower on Company's overall performance the Company had to suffer loss on employment of excess manpower in the Rasayani unit.

The value addition per employee, which was Rs.1.66 lakh in 1999-2000, came down to Rs.1.27 lakh in 2003-04 inspite of implementation of VRS. Corrective measures were needed in the Rasayani unit of the Company to increase its sales realisations and to control the cost of labour and overheads.

1.4.7 Overtime allowance in spite of surplus manpower

In spite of surplus manpower the Company paid overtime allowance to its employees to the extent of Rs.2.72 crore during the period from 1999-2000 to 2003-04. The payment was not justified in the absence of any policy to regulate overtime wages.

1.4.8 Non-formulation of VRS for excess categories of workers

The Company continued to engage certain categories of workers viz., Mathadi workers (59 workers), Society workers (172) and Canteen employees (113) despite the fact that there was no adequate work for them, on account of certain compulsion arising out of protection under the relevant statute and court orders and had to pay wages to the extent

of Rs.3.21 crore during 2001-02 to 2003-04. However, the Company did not formulate any suitable VRS so as to avoid the extra expenditure in this regard.

1.4.9 Comparison of manpower cost

(i) The comparison of manpower cost in the Rasayani unit with that of the Cochin unit of the Company revealed that percentage of manpower to sales realisation in the Rasayani unit ranged between 24 and 40 as against four to 10 in the Cochin unit as per details given below:

(Rs. in crore)

Particulars	1999-2000	2000-01	2001-02	2002-03	2003-04
Sales					
Rasayani	133.93	81.75	93.43	119.88	129.90
Cochin	194.94	272.70	153.11	282.29	299.41
Manpower Cost.					
Rasayani	37.42	33.02	28.82	30.98	30.76
Cochin	11.86	12.14	15.44	15.43	17.61
Percentage of man-power to sales:					
Rasayani	28	40	31	26	24
Cochin	6	4	10	5	6

It would be seen from the above table that as against the industry's norm of six to seven per cent, the percentage of manpower cost in the Rasayani unit ranged between 24 and 40 per cent during the years from 1999-2000 to 2003-04 resulting in extra expenditure on employee cost to the extent of Rs.126.98 crore.

(ii) Besides this, based on the average cost incurred towards fixed cost (excluding interest on borrowings) and profit-volume ratio (P/V ratio) during the last three years ended 31 March 2004, the Rasayani unit had to increase the annual sale value from the present level of Rs.129.90 crore to at least Rs.289.05 crore to achieve break even sales level as detailed below:

(Rs. in crore)

Sl. No.	Particulars	2001-02	2002-03	2003-04
1	Sales	93.43	119.88	129.90
2.	Variable cost	71.05	99.01	117.02
3.	Contribution (1-2)	22.38	20.87	12.88
4.	Fixed cost (employees remuneration & administrative overheads	39.85	43.11	41.56
5.	Operating profit (+)/Loss (-) (3-4)	(-) 17.47	(-) 22.24	(-) 28.68

6.	P/V ratio (3/1) x 100	23.95	17.41	9.92
7.	Break-even sales (4/6) x 100	166.39	247.62	418.95
8	Shortfall in sales to break-even (7-1)	72.96	127.74	289.05

It would be seen from the above table that increase in variable and fixed costs during the period from 2001-02 to 2003-04 resulted in substantial increase in operating loss from Rs.17.47 crore in the year 2001-02 to Rs.28.68 crore in the year 2003-04. It also indicated that the Rasayani unit was not able to recover its fixed cost in any of the three years ended 2003-04.

The Management, while accepting the fact that manpower cost in the Rasayani unit, as a percentage of turnover, was high, stated (October 2004) that the Company had been carrying out review of manpower after the VRS on a continuous basis by carrying out internal exercise. It also added that status of surplus manpower had been put up to Audit Committee/ Board for their consideration and final decision in the matter. As regards payment of overtime, it stated that the statutory payment of overtime as per the Factory Act had been dispensed with and presently overtime wages were paid to the employees who were working on holidays. The Company was finding solution to reduce the cost incurred on casual labourers like Mathadi workers, society and canteen workers.

The above contention of the management is not tenable as the Company had not evolved any suitable system/procedure to effectively monitor the deployment of manpower so as to identify the surplus manpower in time for taking prompt remedial action. Further, the Company could not succeed in formulating any suitable scheme to implement VRS in the absence of sufficient funds to avoid/ minimise the additional cost incurred on surplus manpower/ casual labourers. As regards payment of overtime wages the Company had not framed any guidelines to regulate it, considering the availability of huge surplus manpower.

1.5 Other topics of interest

1.5.1 Irregular payment of productivity-linked bonus.

As per productivity-linked incentive (PLI) scheme approved by the Board in January 1997 in line with DPE guidelines, the amount of incentive was to be worked out based on (a) production performance index (PPI) (b) material utilisation index (MUI) and (c) manpower index (MPI).

The review of payment of PLI for the years 2001-02 and 2002-03 revealed that MPI was worked out at 129 per cent in 2001-02 and 122 per cent in 2002-03 based on the sanctioned manpower without deducting the sanctioned manpower in respect of closed/ inactive plants. Further, the Director (Finance) of the Company while according financial concurrence to the above cited proposal pointed out (16 October 2003) that as per scheme circulated by the Government of India, the installed capacity of the plant was to be taken as base to assess the productivity bonus. However, in computation of productivity-linked bonus the budgeted/target production had been adopted which should be brought to the notice of the Board. He added that pending approval by the Board the amount could be released as an advance. The Chairman & Managing Director of the Company, while accepting the above proposal, directed that the same be put up to the Board for

consideration and approval (17 October 2003). However, the payment was made without the approval of the Board, as envisaged.

Thus, the payment of PLI amounting to Rs.50.54 lakh for the years 2001-02 and 2002-03 made in October 2003 was in violation of the scheme approved by the Board of Directors/ DPE guidelines.

The Management stated (October 2004) that the Company had not violated any rules in the calculation of PLI. The above contention of the Management is not tenable as also observed by the Director (Finance) of the Company.

1.5.2 Avoidable expenditure on surplus manpower in HOC School

The Company established Hindustan Organic Chemicals (HOC) school in the year 1968 for providing facilities of education to the wards of the employees. The Company entrusted (June 1974) the management of HOC school to the Deccan Education Society, Poona. During the period from June 1974 to January 2001, in the absence of proper control over the appointment of qualified teaching/non-teaching staff with reference to the norms of the Department of School Education, Maharashtra, 51 teaching/ non-teaching staff were rendered surplus to the actual requirements.

In January 2002, the Company made an attempt to retrench the 51-teaching/ non-teaching staff members. It could finally relieve/ dismiss the surplus staff only in January 2004 after settlement of compensation to the extent of Rs.26.68 lakh as per orders of the school Tribunal (December 2003). Pending final decision on legal remedy sought by the aggrieved staff, the Company had to pay their salaries during the period from the date of retrenchment (January 2002) to the date of final order (December 2003). Thus, the Company's failure to exercise proper control over the appointment of staff through the Company's representatives in the Advisory committee of the management of the school resulted in an avoidable expenditure of Rs.1.53 crore during March 2001 to December 2003.

The Management stated (October 2004) that the Company had taken due care for the functioning of the school within the framework of rules and resolutions of the Government, through the Deccan Education Society and that the role of the Company's representatives was restricted only to be advisory in nature and the affairs of the HOC school were in the hands of the Deccan Education Society.

The above contention of the management is not tenable in view of the fact that in terms of the agreement with the Society, the Company could have exercised proper control over the appointment of the staff as the financial commitment on account of appointment of additional staff required the approval of the advisory committee in which two representative's of the Company were included.

1.6 Conclusions

The review of manpower analysis of the Company revealed that the high incidence of expenditure on employee cost over and above the industry norm in the Rasayani unit and lack of any system to monitor and deploy surplus manpower coupled with non-implementation of VRS after April 2002 due to financial constraints impinged heavily on the economic running of the unit. There is urgent need for taking steps for optimum and economical utilisation of manpower to revive the Rasayani unit.

1.7 Recommendations

(a) The Company should review the strategies pertaining to manpower especially in the backdrop of significant number of plants/projects undergoing closure.

(b) The Company needs to initiate urgent steps to bring down the high cost of manpower utilisation in the Rasayani unit in line with the industry norm.

(c) There is urgent need to reduce cost of operation of the Rasayani unit by modernisation/ up-gradation of plants and to increase its sales realisation, optimisation of facilities available under inactive/closed plants, with specific strategies to effectively counter the competition along with a programme of financial restructuring, as the continuation of the Rasayani unit in the present form would be a further financial drain on the exchequer.

The review was issued to the Ministry in November 2004; its reply was awaited (March 2005).

MINISTRY OF CIVIL AVIATION

CHAPTER : II

Air India Limited

Inadequate Expenditure Control in Regional Office of Air India at New York

Highlights

Air India incurred an avoidable expenditure of US$ 1,45,553 (Rs.63.43 lakh) during the period between August 2003 and December 2004 due to delay in award of contract for security services at JFK airport and consequent increase in the rates for the services.

(Para 2.3.1)

Air India failed to secure discount/incentives amounting to US$ 68,467 (Rs.31.54 lakh) for the period from April 2002 to December 2003, which were available to it under a contract for supply of meals/food items required for its flights out from the airports at New York and Newark.

(Para 2.3.2)

Air India allowed two days lay over to its cabin attendants at New York, against the lay over of less than a day required as per the guidelines of the Civil Aviation Department of the Government of India. This resulted in avoidable expenditure of US$ 9,21,698 (Rs.4.50 crore) per annum during 2000-2002 on account of provision for accommodation for lay over for the additional day to the cabin attendants at New York.

(Para 2.3.5)

2.1 Introduction

The Air India Limited operates international flights as well as flights within India. The Headquarters of Air India is in Mumbai and the services are organised and managed through various Regional Offices located in India and abroad. The Regional Director's office of Air India at New York is the regional headquarters for Air India's USA and Canada operations. Air India operated daily flights between Mumbai and New York, Mumbai and Newark and six flights a week between Mumbai and Chicago. The Regional Director also controls a Material Management Department located at New York to facilitate the purchase/repair of spares/stores for Air India's fleet from USA/Canada.

The international airline industry was passing through a turbulent phase after the incident of 11 September 2001 and it became essential for all airlines to resort to cost cutting measures to remain in operation without incurring loss. The working of the Air India office at New York was reviewed against this background.

2.2 Scope of Audit

Air India's operations in the New York/Newark sector during the year 2002-03 were reviewed in audit to study their economy, efficiency and effectiveness. For this, Audit conducted test check, in November 2003/January 2004, of records connected with contracts relating to outsourcing of services, lay over period provided to cabin

attendants and the accounting system in the Regional Office, besides the Material Management Department, at New York.

2.3 Audit Findings

The review of the operations in New York and Newark revealed that Air India incurred avoidable/extra expenditure due to lack of adequate internal controls over its outsourced activities as well as non-adoption of economy measures within the organisation as highlighted in succeeding paragraphs.

2.3.1 Avoidable expenditure/liability for security services

(a) The security services for Air India at JFK airport in New York were outsourced to outside agency M/s. Aviation Safeguards without signing any contract, effective from January 2002, despite the agency's offer in December 2001 to hold the then existing rates i.e. US$ 10.50, US$ 11.50 and US$ 14.00 for normal hours of Security Officer, Security Supervisor and Senior Security Supervisor respectively. The offered rates were valid for two years with two per cent increase for the third year if a three-year contract was awarded. There was, apparently, a delay in approval of the quoted rates by Air India Headquarters (June 2002) and the Regional Office failed to follow it up with the agency in order to have a valid contract for the rates.

In July 2003, the agency enhanced its rates to US$ 12.50, US$ 13.50 and US$ 16.00 respectively, which were higher by more than 15 per cent when compared to the rates quoted by it in December 2001. The agency informed Air India (November 2003) that it would discontinue its services from December 2003 if it were not paid at the enhanced rates. Having no alternate arrangement in place for the security services, Air India paid the enhanced rates from August 2003. Air India invited fresh tenders and the lowest rates received from the same agency were approved from December 2003. These rates were also higher than the rates approved by Air India Headquarters in June 2002 but marginally lower than the enhanced rates paid from August 2003.

The additional amount that Air India paid on account of the increase in rates worked out to US$ 25,598.42 for the period from 4 August 2003 to October 2003 and the total impact was estimated to be US$ 1,45,553 (Rs.63.43 lakh*) upto December 2004 i.e. till the expiry of the three years' contract period from January 2002 to December 2004, if the contract for this period had been awarded by Air India against the agency's offer of December 2001.

The Regional Management of Air India stated (March 2004) that it had to reluctantly accept the increased rates since the agency was threatening to withdraw the services if the increase in rates was not granted. They added that it was not sure if a signed contract would have prevented the increase in rates. The contention of the Regional Management is not acceptable, as a valid contract would have created a legal obligation on the agency to stick to the agreed rates. Response of the Management of Air India Headquarters was awaited (January 2005).

(b) Documents for recording 'Time In' and 'Time Out' of personnel working under the Security Services and Ground Handling contractors were not maintained. In respect of security services provided to Air India at Newark, M/s Haynes Security Services, under a contract valid from December 2002 to November 2005, demanded payment for

* *@ one US$ = Rs.43.58, as of 31 December 2004*

extra hours which, as per Air India's contention, were not payable. Air India had contended that most (Haynes) employees spent less than eight hours working for Air India whereas the security agency billed at least eight hours for every one day. The only legitimate basis for determining the actual hours worked by each employee was the sign-in sheets that were signed by each employee contemporaneously at the time of arrival to work and at the time of departure. In the absence of 'Time In' and 'Time Out' records, Air India was unable to disprove the claim of the contractors and had to incur an avoidable expenditure of US$ 10,966 (Rs.5.03 lakh[♦]) towards out-of-court settlement reached in September 2003.

The Management stated (October 2004) that comments of the concerned department were called for and they would revert on the issue after the same were received. The Management's response was awaited (December 2004).

2.3.2 Extra expenditure in catering

Air India, Mumbai, entered into a 'Catering Cabin Service Agreement' with Flying Food Group in April 1999 for supply of all meals and other food items required for its flight out of JFK airport at New York for a period of three years upto March 2002, which was later extended to July 2002 on the same terms and conditions. In December 2002, the service was extended to cover flights introduced from Newark. The Regional office failed to secure the benefits of discounts/incentives amounting to US$ 68,467 (Rs.31.54 lakh) allowed by the contractor as per details given below:

- Prompt payment discount of two per cent in five invoices in JFK airport and two invoices in Newark, resulting in a loss of US$ 13,037 (Rs.6.19 lakh[♥]) during 2002-03,
- Volume discount of US$ 3,430 (Rs.1.63 lakh[♥]) during 2002-03 and
- Admissible additional incentives of US$ 1000 per week for the first one year operation from December 2002 in respect of Newark, leading to a cumulative amount of US$ 52,000 (Rs.23.72 lakh[♠]).

It was further observed that, in August 2002, the food ordered and paid for was in excess of the number of passengers by 23 per cent. Further, in one case, when cancellation of flight could not be intimated in advance, the supplier was paid US$ 4,287 billed arbitrarily for unusual pattern of 320 non-vegetarian meals, with no vegetarian meals.

The Management stated (October 2004) that prompt payment discount could not be availed of during 2002-03 as the invoices were received late and due to exigencies of work the amount could not be paid within the stipulated period of ten days. They added that a mechanism had been put in place to ensure expeditious payments in future. Regarding the volume discount and the additional incentive, the Management stated that the matter was being resolved with the contractor and in respect of the arbitrary billing for 320 meals the necessary clarification was sought from the Caterer. However, the reasons for ordering the additional meals, in excess of number of passengers, were not furnished to Audit.

[♦] *@ one US$ = Rs.45.85 as of 29 September 2003.*

[♥] *@ one US$ = Rs.47.50 as of 31 March 2003.*

[♠] *@ one US$ = Rs.45.61 as of 31 December 2003.*

2.3.3 Extra expenditure in hiring of transport

There were no negotiated and agreed terms for hiring of transport services by the Regional office at New York, other than for crew and passengers. During 2002-03, Air India hired transport on need basis from M/s Bentley Limousine Service on payment of US$ 100,304. The hire rates of car for in-town trips were US$ 35 to US$ 45 per hour plus 20 per cent gratuity, as against US$ 20 per hour paid by the India Mission in New York. Thus, there was an estimated extra expenditure of US$ 50,000 (Rs.23.75 lakh*) on this account.

The Management stated (October 2004) that the services were obtained from the same service provider considering their reliability and secured services. The Management further stated that they could get a reduction in the gratuity rate by 50 per cent in their fresh quotation received against tenders invited by them recently. Audit observed that the rates accepted by Air India were still high compared to the rates secured by the Indian Mission in New York and, therefore, it needed to explore further competitive rates in the matter.

2.3.4 Inadequate maintenance of accounts at New York

The Regional office at New York maintained only cash books in respect of six Bank Accounts operated in New York. Apart from cash books no other basic accounting records like Journals, Ledgers, Purchase/Sales books, trial balance, etc. were prepared. However, the Chief Accounts Officer at Mumbai was making the accounting entries and maintaining the complete set of accounts. It was observed that there would have been better control over expenditure and performance measurement was possible if separate accounts were maintained at the Regional Offices. The non-maintenance of accounts on double entry accounting concept had the risk of losing control over collection of sundry debts, omitting adjustment entries for non-cash transactions etc. as highlighted below.

As of 31 March 2003, an amount of US$ 3.747 million (Rs.17.80 crore*) was outstanding under the sundry debtors account on account of traffic revenue due from agents and others. No confirmation of balances was obtained from the parties. An amount of US$ 0.375 million was considered good despite the same being outstanding for more than three years.

An amount of US$ 0.347 million was shown as outstanding from various Station Managers. These were mainly debit notes, which needed to be paired off against credits due to these stations. This had not been done.

The Regional office showed an amount of US$ one lakh as dues from its Transport Service Contracts that provided air transportation to parties in exchange for supplies made/services rendered. The amount represented only the value of transport utilised by the parties. This resulted in overstatement of Sundry Debtors and understatement of expenditure and thus the non-passing of journal/adjustment entries for non-cash transaction had a bearing on the corporate accounts.

The Management stated (October 2004) that they proposed to introduce Double Entry Accounting Concept at each station to enable them prepare their own trial balance. The debts shown against station managers were several years old and write-off action was

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** @ one US$ = Rs.47.50 as of 31 March 2003*

** @ one US$ = Rs.47.50 as of 31 March 2003.*

awaiting approval from sanctioning authority. Regarding the adjustment entries in respect of Transportation Service Contracts, the Management confirmed that all the pending adjustment entries had since been made on the basis of the Audit observation. The fact remains that proper maintenance of accounts was essential to ensure correctness of accounts, prompt action to realise debts and confirmation of balances from the parties concerned. The ongoing deliberations on the proposed implementation of Double Entry Concept at each station may only minimize the existing weakness in the system.

2.3.5 Additional lay over for crew at New York and consequential expenditure

According to the orders issued by the Civil Aviation Department of the Government of India in August 1997, where the flight time of cabin attendant in international sector was less than 11 hours, a pro rata rest period of twice the flight time shall be provided at base. The flight operated by Air India to New York had cabin attendants boarding from London and the flight time was 6 hours and 35 minutes. The cabin attendants were provided lay over for 48 hours, which was much in excess of the prescribed period. Air India incurred an expenditure of US$ 921,698 (Rs.4.50 crore♦) per annum during 2000-2002 on account of provision of accommodation for lay over for additional day to cabin attendants at New York, which was avoidable. The Regional Management stated in March 2003 that in terms of 'record note of understanding in March 1995' it was agreed by the Management to give two days' lay over as against the earlier practice of giving one day in this sector.

The Corporate Management stated in October 2004 that they would endeavour to take up the issue with the Association during the wage negotiations. The fact remains that the Management did not do so, in order to reduce the expenditure as per international practice, though the Civil Aviation Department had issued the order way back in August 1997.

2.3.6 Non-accounting of Passenger Service Orders

The Regional office received blank copies of Passenger Service Orders (PSOs) from Air India's Mumbai office. These were machine numbered documents used for authorising entitled passengers to use hotel and transport services from the designated hotel/agency. There was no control record to indicate the receipt, distribution and utilisation of these documents and to ensure that these documents were not misused.

The Management acknowledged (October 2004) the necessity of the control record and confirmed that the system had since been strengthened.

2.3.7 Continuation of Material Management Department (MMD) in New York

MMD, New York was set up in 1964 to facilitate purchase of spares/stores from USA and Canada for Air India. Indian Airlines Limited had also been availing of its services till January 2000 when the services were discontinued, considering the improved communication facilities. During 2002-2003, out of 20682 Purchase Orders placed by Mumbai on suppliers in USA and Canada, orders based on quotations received by MMD were only 1567, representing 7.04 per cent of the total orders. The Regional Office made payments for the supplies. MMD did not have a databank of the vendors and had no practice of negotiating rates. The role of MMD in facilitating purchases was evidently not significant. Since follow up of the orders could be done at Mumbai due to the faster

♦ *@ one US$ = Rs.48.80 as on 28 March 2002.*

and cheaper means of communication and preference to electronic orders by the suppliers in USA/Canada, the necessity of continuing MMD in New York needed review.

The Management stated (October 2004) that they had already downsized the employees' strength of MMD at New York and argued that continuation of the office at New York was necessary to sustain the operations and to provide support to Engineering and other related departments. The Management added that the office had the responsibility of correlating receipts and authorising payments for over 20000 invoices per annum. It was, however, observed that, in November 1999, Indian Airlines Limited had decided to follow the centralised purchase from India considering the improved communication facilities and the consequent saving of about Rs.80 lakh to Rs.90 lakh per annum. Therefore, a cost-benefit analysis needs to be carried out to justify the continuation of MMD.

2.4 Conclusions

The expenditure of aggregating to US$ 11,96,684 (Rs.5.74 crore) was avoidable in respect of outsourced services for security, transport and catering as well as the excessive lay over period. This included the extra expenditure of US$ 9,71,698 (Rs.4.74 crore), in respect of hiring of transport services at uncompetitive rates and the excessive lay over period to cabin attendant, which was of recurring nature annually. Non-maintenance of adequate accounts at the Regional Office led to uncontrolled accumulation of debtors and the risk of omitting non-cash transactions.

2.5 Recommendations

- Adequate control mechanism should be put in place in order to obtain competitive rates and ensure verification of the bills of the contractors for outsourced services for security, transport and catering.
- The excessive lay over period should be reduced without delay.
- Adequate accounting system should be introduced to ensure proper accounting of all cash & non-cash transactions and control over the outstanding dues.
- Cost-benefit analysis of MMD should be carried out to justify its continuation, keeping in view the faster and cheaper communication facilities presently available world-over.

The review was issued to the Ministry in February 2005; its reply was awaited (March 2005).

MINISTRY OF COAL

CHAPTER : III

Bharat Coking Coal Limited

Performance of Madhuband Washery

Highlights

The Management set up Madhuband Washery with a washing capacity of 2.5 million tonne at a point when existing capacity was underutilised.

(Para 3.3.1)

The implementation of the project was delayed by 12 years and five months resulting in cost overrun by Rs.125.33 crore with reference to original sanctioned capital outlay.

(Para 3.3.3)

The implementation of the project of railway siding was delayed by seven years resulting in cost overrun of Rs.7.19 crore.

(Para 3.3.4)

The Block-II Open Cast Project (linked mine of Madhuband Washery) did not perform well since it came into operation. Its operation had to be stopped in June 2001 due to failure to obtain physical possession of a patch of land. The Management could not ensure supply of coking coal of suitable quality to the washery either from Block-II OCP or from alternate sources.

(Para 3.3.5)

The average capacity utilisation of the washery was 22.46 per cent and it sustained a loss of Rs.127.03 crore during the last five years ending 31 March 2004. The decision to convert the washery for washing non-coking coal instead of coking coal amounts to wastage of the capacity created for specific purpose.

(Paras 3.4 and 3.3.2)

The finalisation and award of the contract was done without taking into account the commercial considerations. As a result, BCCL had to bear an extra expenditure of Rs. 18.15 crore.

(Para 3.5.1)

The washery had to sustain a loss of Rs.2.67 crore towards under loading and over loading charges due to non-installation of belt-weigher.

(Para 3.5.2)

The washery was put to operation in incomplete shape without adequate load trial run and performance test. This had caused breakdown of certain equipment. The Management rectified some defects at a cost of Rs.91 lakh. However, further deficiencies and imbalances were noticed whose rectification will involve an estimated cost of Rs.2.07

crore. Some equipment/production circuit worth Rs.13.38 crore were either bypassed or could not be put to operation properly.

(Para 3.5.3)

Despite substantial under-utilisation of capacity management paid extra overtime of Rs.4.60 crore for operation of the washery on Sundays/holidays.

(Para 3.6)

3.1 Introduction

Bharat Coking Coal Limited (BCCL) was formed in January 1972. It took over 214 coking coalmines producing 14 million tonne per annum when they were nationalised in May 1972. Later on 182 non-coking coalmines, nationalised in 1973, were also entrusted to this Company. It became a subsidiary of Coal India Limited in 1975. As on 31 March 2004, BCCL was running 49 coking coalmines with a production capacity of 8.77 million tonne as on 1 April 2003 and ten washeries with a capacity to wash 15.13 million tonne raw coal per annum. The washeries are required for beneficiation of coking coal as the coal mined cannot be used in the steel plants without beneficiation.

In order to meet the demand for washed coking coal from steel plants, it was decided to set up Madhuband Washery with raw coking coal input capacity of 2.50 million tonne per annum with average ash content of 29.50 per cent to produce washed coal with average ash content of 17 per cent.

3.2 Scope of the Review

The review covered the formulation, construction, utilisation and other aspects of Madhuband Washery since its inception till March 2004. For this purpose records of Washery Construction Division, Washery Division, Block-II Open Cast Project (OCP) and Estate Department of BCCL were reviewed during the period from October 2003 to January 2004. Some of the aspects relating to implementation of the project, capacity utilisation and lacunae in awarding contract are detailed in the succeeding paragraphs.

3.3 Project implementation Issues

The Project Report of Madhuband Washery as approved in March 1985 envisaged an estimated capital investment of Rs.71.90 crore including Rs.9.29 crore as divertible from mine project (Block- II OCP) with anticipated completion schedule in 1988-89. Due to delay in execution, the total cost of the project was revised to Rs.194.18 crore in October 1993 with a revised schedule for completion by March 1995.

In the course of audit various aspects of project implementation were reviewed and some of the main weaknesses observed are discussed in the succeeding paragraphs.

3.3.1 Excess washing capacity built up

When the proposal for setting up Madhuband Washery was under active consideration (1981-82 to 1985-86) the supply of raw coking coal to the then existing seven washeries was only 7.65 million tonne on an average against their washing capacity of 11.52 million tonne per annum. Despite having idle capacity, the Management proposed in February 1982 to set up Madhuband Washery with 2.5 million tonne washing capacity when their existing washeries could not be utilised fully.

The Management stated (June 2004) that the existing washeries were not designed to wash raw coal mined from open cast mines and were not in a position to meet the demand of steel plants even at their full capacity utilisation.

The Management's contention is not tenable in view of the fact that production of raw coal at Block-II OCP from 1983-84 onwards was supplied to Dugda Washery which was also not designed for washing raw coal mined from open cast mines.

3.3.2 Mid-stream change for production of non-coking coal

One of the main reasons for implementing the Madhuband Washery project was to improve the quality of coking coal so as to make it compliant with the requirement of steel plants.

It was observed that in the meeting of Inter Ministerial Group (February 2002), the Management suggested utilising the washery for washing non-coking coal. The Ministry of Coal viewed that the technology of Madhuband Washery was of latest origin and utilising this for washing non-coking coal would be a waste of the capacity created and against the interest of the nation. But in view of the refusal of Steel Authority of India Limited (SAIL) to accept washed coal of Madhuband Washery due to its inferior coking property and also due to non-availability of raw coking coal for feeding the washery, the Management started washing non-coking coal in June 2003 for supply of 'washed power coal' to power houses. This was done without any change in the basic design of the washery and keeping the option open to wash coking coal when available. The conversion proposal was approved by the Board of Directors of BCCL in August 2003 which envisaged that the yield of 'washed power coal' would be 79 per cent and washery would generate a profit of Rs.1.85 crore per annum at 65 per cent capacity utilisation. However, it was found that the capacity utilisation of the washery by washing non-coking coal was only 23.54 per cent and the washery sustained a loss of Rs.25.10 crore in 2003-04.

Thus, the basic purpose of setting up the washery, of narrowing the gap between demand and supply of coking coal for steel plants from indigenous sources was frustrated.

The Management stated (June 2004) that non-availability of raw coking coal from Block-II OCP due to land acquisition problem could not be foreseen. Decline of coking coal production from other mines of BCCL mainly due to financial crunch of BCCL aggravated the position of availability of indigenous prime coking coal, which necessitated import by SAIL.

The Management's contention is not tenable as the problem of land acquisition of Block-II OCP was known to BCCL at the planning stage of the washery (1982) which could not be resolved till date (October 2004).

3.3.3 Time and cost overrun

The construction of Madhuband Washery started in January 1986 and as per contract washery was to be commissioned in December 1988 at a sanctioned capital outlay of Rs.71.90 crore (March 1985). It was, however, declared complete only in May 2001 at a cost of Rs.197.23 crore. There was thus a time overrun by about 12 years and five months and cost overrun of Rs.125.33 crore in the commissioning of the project.

The Department of Programme Implementation was requested by the Public Investment Board (PIB) in January 1992 to carry out an enquiry into the causes of time and cost

overrun with a view to fixing responsibility and for learning lessons so that such delays might not occur in future.

After examination of views of BCCL, the main contractor executing the project, Mining and Allied Machinery Corporation(MAMC) and Hindustan Steel Works Construction Limited (HSCL-sub-contractor of MAMC), the Department of Programme Implementation identified various causes of time overrun, viz.

(i) delay of about nine months in entering into contract after sanction,

(ii) delay of about one year due to controversy over the choice of 'Jigs' raised by MAMC,

(iii) delay by about four and half years in releasing 'drawings' to HSCL by MAMC,

(iv) slow construction work by HSCL,

(v) inability of MAMC in supervision and control,

(vi) occasional shortage of steel and cement,

(vii) bad industrial relations and

(viii) resource constraints.

Audit scrutiny revealed that delay in execution of the work further continued after January 1992 due to various reasons viz.

(i) delay in releasing payment of bills to MAMC,

(ii) slow execution of work by MAMC and its sub-contractors despite a number of review meetings between BCCL and MAMC on the progress of work which remained ineffective due to non-fulfillment of assurances given by the implementing agencies and

(iii) change of original location of Madhuband Washery before awarding the contract keeping in view the constraints in acquisition of forest land. Despite this, the Company took about six years in acquisition of land for construction of raw coal cross-country conveyor, product cross-country conveyor, loading station and railway siding.

The Management stated (June 2004) that though original application for acquiring forest land was made over the period from January 1985 to March 1987, revised application had to be made in May 1991 since the Forest Department was not handing over the land. Forest land was handed over to BCCL in April 1996. The acquisition of a portion of tenanted land was delayed because of confusion over ownership, which was prevailing from November 1987 till January 1996.

The reply of the Management corroborated the fact that there was inordinate delay of about six years in making revised application in respect of forest land and nine years in obtaining clearance over ownership from the Government with regard to tenanted land.

3.3.4 Delay in construction of Railway Siding of Madhuband Washery

The contract for construction of Railway Siding at Madhuband Washery was awarded to RITES Limited in January 1991 at an estimated cost of Rs.12.30 crore plus 12.50 per cent

fee for project management services with the stipulation that the project was to be completed within a period of 24 months from the commencement of work.

It was observed that the work on railway siding commenced in March 1991 and completed in March 2000 at a cost of Rs.19.49 crore. Thus, there was a cost overrun by Rs.7.19 crore and time overrun of seven years in completion of the project. It was further observed that there were no milestones on record for carrying out different activities relating to construction of railway siding.

The Management stated (June 2004) that Letter of Intent (LOI) for preparation of Detailed Project Report (DPR) for rail infrastructure was issued to RITES Limited (RITES) in September 1984. The DPR was prepared in September 1987, which was approved by South-Eastern Railway in February 1989. RITES made a supplement to DPR in June 1989 and LOI for construction of railway siding was issued to RITES in January 1990.

The Management while accepting the facts (June 2004) explained the delay in awarding the contract for construction of railway siding. It confirmed that there were no milestones for carrying out different activities relating to construction of railway siding, based on which slippage could be analysed.

3.3.5 Poor performance of linked coal mine (Block-II Open Cast Project)

The Madhuband Washery project envisaged the smooth flow of raw coal from a mine to washery. Accordingly it was decided to utilise the good quality coking coal from Block-II OCP mine. No action plan was drawn up for provision of coking coal from alternate sources in the event of contingencies.

In the course of scrutiny in audit it was observed that the linked mine which came into operation in 1983-84 stopped production in June 2001. This was due to failure to obtain physical possession of 112.61 acres of land in the Kessurgarh Mouza. All major equipment were shifted to neighbouring open cast projects producing mainly non-coking coal. In view of stoppage of production from Block-II OCP and non-availability of coking coal from alternate sources, non-coking coal to the extent of 95 per cent of total feed to the washery was provided from neighbouring open cast mines in the year 2003-04. As a consequence the very purpose of receiving good quality of raw coal from a dedicated source was defeated.

The Management stated (June 2004) that augmentation of coking coal from alternate sources could not be made due to severe financial crunch of BCCL.

It is evident from the reply of the Management that the linkage of dedicated mine with the washery was not synchronized with the requirement of the washery and this resulted in the washery having to utilise non-coking coal instead of coking coal, which undermined the purpose of coal beneficiation for steel plants.

3.4 Performance particulars

The review of Madhuband Washery in terms of certain key performance parameters during the last five years ending 31 March 2004 is detailed as under:

Particulars	As per Project Report	1999-00	2000-01	2001-02	2002-03	2003-04 (Prov.)
Production performance						
Raw Coal Feed (in MTs)	25,00,000	3,02,500	4,31,800	6,81,500	6,51,800	5,88,600
Ash percentage in Raw Coal	29.50	34.40	37.70	46.28	45.24	43.81
Capacity Utilisation percentage	-	18.15	17.27	27.26	26.07	23.54
Washed Coal Production (in MTs)	11,30,000	1,14,985	1,35,529	1,37,130	1,47,365	15,839*
Ash percentage. in Washed Coal	17.00	19.70	19.97	19.90	20.05	20.23
Yield percentage	45.20	38.01	31.39	20.12	22.61	2.69
Financial Performance						**(Rs. in crore)**
Cost of production	-	39.88	57.85	55.92	55.18	79.49
Sale Value	-	22.68	22.90	29.65	31.38	54.40
Loss (after prior period adjustments)	-	17.21	34.84	26.27	23.61	25.10

The scrutiny of data on performance of the washery reveals that the washery was making losses continuously since inception. It sustained a loss of Rs.17.21 crore in 1999-00, Rs.34.84 crore in 2000-01, Rs.26.27 crore in 2001-02, Rs.23.61 crore in 2002-03 and Rs.25.10 crore in 2003-04. The average capacity utilisation during the last five years ending 31 March 2004 in terms of raw coal throughput was only 22.46 per cent. The average ash content in raw coal was as high as 46.28 per cent in 2001-02 and 43.81 per cent in 2003-04 as against the projected level of 29.50 per cent and ash percentage in washed coal ranged from 19.70 per cent to 20.23 per cent during 1999-00 to 2003-04 as against of 17 per cent projected. Further, actual yield of washed coal also declined from 38.01 per cent in 1999-00 to 22.61 per cent in 2002-03 as against 45.20 per cent envisaged in the Project Report. Due to non-availability of raw coking coal for feeding the washery, the Management started washing non-coking coal from June 2003 onwards.

Reasons for such poor performance were:

* *the washery ceased production of washed coking coal from May 2003*

(i) failure to ensure supply of quality coal to the washery in required quantity and

(ii) existence of many deficiencies and bypassing of equipment in different sections of production process.

The Management (June 2004), while admitting the above facts, stated that bypassing of operation of certain equipment was necessary as per characteristics of present raw coal feed.

3.5 Infirmities in selection of contractor

Injudicious choice for construction of washery

3.5.1 As per accepted commercial practices, while taking a decision on finalisation of tender process any commercial undertaking should satisfy itself about various aspects of credibility of the bidders. Among others these include technical competence, past experience and performance, financial soundness of the bidders and the competitiveness of the bids.

In the course of scrutiny it was observed that the Company decided, after evaluation of global tender invited in 1982 for selection of contractor for construction of the washery, to award the turnkey project to the lowest bidder, a Consortium of Voest Alpine AG, Triveni Structurals Limited and Industrial Consulting Bureau at a cost of Rs.54.35 crore. At this stage, the Secretary (Department of Heavy Industries) strongly recommended (March 1984) awarding the contract to Mining and Allied Machinery Corporation Limited (MAMC), the fourth lowest bidder. Finally, the contract was awarded (December 1985) to MAMC at a higher price of Rs.72.50 crore excluding taxes, duties and escalation. The project was scheduled to be completed by December 1988.

The following deficiencies were observed in the process of award of contract to MAMC:

(i) The contract was not awarded to the lowest bidder. As a result, BCCL had to bear an extra expenditure of Rs.18.15 crore being the difference between the lowest bidder and MAMC.

(ii) Past performance of MAMC in washery construction was not found suitable. In the case of construction of Moonidih Washery of BCCL and Rajrappa Washery of Central Coalfields Limited constructed by MAMC there was considerable time and cost overrun.

(iii) Sufficient basic data of raw coal characteristics, which would decide the selection of process equipment, were not provided, as coal samples from the linked Block-II OCP were not used. The design of the process and equipment was worked out based on quality of coal samples obtained from other mines namely Benedih and Madhuband collieries.

(iv) While the Department of Heavy Industries was to monitor the activities of MAMC for setting up the washery in time the delayed implementation reflected absence of monitoring by that Department.

The failure of management to adhere to standard commercial principles in awarding the contract led to an injudicious choice of contractor. This resulted in delay of 12 years and five months in project implementation besides a cost overrun of Rs.125.33 crore in the project.

The Management stated (June 2004) that sufficient basic data of raw coal characteristics was provided in Notice Inviting Tender (NIT) except screen analysis, as Block-II OCP did not start production at the time of preparation of Notice Inviting Tender in February 1982.

The screen analysis plays an important role in selection of the type, size and capacity of the washing equipment. As negotiation was going on with the contractor on various issues till May 1985 and the orders for imported and indigenous equipment were issued in March 1987, the screen analysis of coal produced at Block-II OCP could have been made available to the contractor through an addendum to NIT in 1983-84 itself when production in Block II OCP started.

3.5.2 Avoidable expenditure due to delay in installation of weighbridge

As part of project report the railway siding at Madhuband Washery was to have a weighbridge for the purpose of final weighment of loaded wagons. The contract for installation of weighbridge was awarded to Avery India Limited (sub-contractor) by RITES in December 1999 at a cost of Rs.21.12 lakh. The weighbridge was scheduled to be installed by February 2000.

RITES completed the work of installation of 'Electronic In-motion weighbridge' worth Rs.21.12 lakh in March 2000. The belt weighers worth Rs.5.73 lakh were to be installed on loading belts to assess the correct quantity loaded into wagons so that underloading and overloading could be avoided on final weighment of wagons at the weighbridge. The belt weighers supplied by MAMC in February 1990 had to be subsequently replaced in July 2001 due to obsolescence. The weighbridge was finally commissioned in March 2004. The delay in commissioning was due to delay in stamping of weighbridge by Weights & Measures Department of the State Government, delay in obtaining approval of the system from Research Designs & Standards Organisation, delay in rectification of damaged cables and delay in testing of weighbridge with loaded wagons. The weighbridge, though commissioned, was not in operation till date (October 2004).

It was observed that in the absence of belt-weighers and weighbridge, the washery started loading wagons on eye-estimation basis and weighing the wagons at another weighbridge (Khanudih) from October 2000 onwards, As a result, the washery had to sustain an avoidable expenditure of Rs.2.67 crore towards underloading and overloading charges during the period October 2000 to March 2004.

The Management stated (June 2004) that loading was done from October 2000 onwards only on approximate basis and eye estimation due to absence of weighing instrument and presence of inexperienced manpower. So, underloading and overloading could not be avoided. Further, for technical reasons, underloading/overloading could not be totally eliminated in spite of operation of belt weighers.

The reply is not tenable as scrutiny of records revealed that the technical reasons were mainly (i) mal-functioning of the weightometer, (ii) uneven loading belt and (iii) inconsistent flow rate of products on belt. Thus, the basic purpose of avoiding underloading/overloading of wagons, for which the belt-weighers and weighbridge were commissioned in close proximity, was defeated due to malfunctioning of the belt-weighers and non-operation of the weighbridge.

3.5.3 Failure to implement contractual clauses

Provisions of clause 30 of the contract inter alia provided that MAMC would conduct, formally, 'load trial run' and 'performance test' of the plant to start commercial production by December 1988. MAMC was required to inform the management that the plant was ready for 'trial run on load' after completion of no-load trial of the equipment and plant section and to arrange utilities and feed coal of quality required for 'load trial run' two weeks in advance.

In the course of audit it transpired that there were number of deficiencies in operationalising Madhuband Washery. The main points are discussed in the succeeding paragraphs:

(i) The load trial run of equipment and plant should have been done by MAMC. However, the washery was put to 'load trial run' in February 1998 by the Management with facilities to the extent built-up by MAMC. The representatives of MAMC were not involved in the 'load trial run' initiated by the Management;

(ii) When the 'load trial run' was conducted, the product loading conveyor, loading complex, railway siding and one out of two 'Jigs' were yet to be completed/commissioned. Besides, a number of works remained either incomplete or not completed properly;

(iii) In the course of 'load trial run', various defects were observed. The Management rectified some of these defects at a cost of Rs.91 lakh between January 1998 and March 2001 in order to continue the operation of the washery. Further deficiencies in equipment were observed the removal of which entailed an additional estimated expenditure of Rs.2.07 crore. Besides this, some equipment (jig, froth floatation plant dedusters, heavy media cyclone circuit and centrifuges) worth Rs.13.38 crore, which were selected on preconceived ash parameters of raw coking coal, were later found not suitable. These equipment have been lying idle from between 1998 and 2001 till date;

(iv) The Management tried to run the washery without adequate performance test and arrangement of desired quality of raw coking coal in required quantity. This led to interrupted operation of the washery and consequent failure to achieve the designated performance of the washery;

(v) The washery developed a number of technical snags during the course of operation, which were partly rectified by the Management at 'the risk and cost' of MAMC. The Company raised a claim of Rs.6.09 crore on MAMC in September 2002 which was revised upward to Rs.6.17 crore in February 2004 for recovery of cost incurred on removal of some deficiencies in the plant and also for recovery of house rent, electricity charges, unadjusted mobilisation advance and materials supplied to MAMC. Further, a claim of Rs.3.63 crore was raised against MAMC in March 2004 towards liquidated damages for late delivery of the plant and non-attainment of performance guarantee. However, the recovery of these claims was doubtful, as MAMC had gone under liquidation in July 2003;

(vi) The project was declared complete in May 2001 on the premise that the washery could achieve 80 per cent of its daily rated production on the basis of another 'load trial run' conducted on a particular day on 24 March 2001 of the

main washery plant only. The 'trial run' was conducted in terms of raw coal throughput only, without taking into account 'trial run' of integrated circuit. The project completion report prepared based on this 'trial run' was approved by the Board of Directors of BCCL in July 2001 and was submitted to the Government for approval in December 2001, which was yet to be approved.

The Management stated (June 2004) that it was the responsibility of MAMC to start and carry out load trial run with their engineers as per terms of the contract but MAMC withdrew their engineers gradually. In these circumstances, BCCL had to continue 'load trial run' further in the national interest so that the plant with huge investment did not remain idle. The efforts made by BCCL to get the rectification works done by MAMC were in vain. The situation was unavoidable and could not be foreseen. The desired quality of raw coal could not be fed to the washery from the mineable front of Block-II OCP. The interrupted operation of the washery was beyond the control of BCCL as MAMC failed to rectify the defects observed during 'load trial run'. Further, they stated that MAMC was responsible for the various failures due to poor workmanship of the equipment supplied by them.

The reply of the Management confirms the contention of Audit that the selection process of the contractor was flawed.

3.6 Wasteful expenditure on overtime

A monthly normative budget is prepared based on monthly target of production. Monthly actual expenditure is compared with monthly budgeted expenditure. Cost controls are accordingly exercised. There was no provision in the Project Report to operate the washery on overtime and on Sundays/holidays/alternate rest-days even at its designed capacity to wash raw coking coal of 2.5 million tonne per annum.

It was observed that extra expenditure of Rs.4.60 crore was incurred for operation of washery on overtime and on Sundays/holidays/alternate rest-days during the period from 1999-00 to 2003-04. These operations attracted payment to the workers at double the normal rate and, in some cases at normal rate, with alternate rest-day while utilisation of capacity ranged from merely 18 per cent to 24 per cent during this period.

The Management stated (June 2004) that deployment of manpower on overtime and Sundays/holidays was necessary for receipt of raw coal and despatch of washery products as wagons were supplied on Sundays etc. to take care of absenteeism and also for maintenance and emergent nature of work.

But records revealed that there was still three-shift operation of the washery including one shift meant for maintenance. In view of substantial under utilisation of capacity, the Management should have avoided the operation of the washery on overtime in order to reduce losses.

3.7 Conclusions

As a result of faulty planning at the conceptual stage, failure to properly evaluate the feasibility of the project, unrealistic assessment of the source and supply position of coking coal and inadequate care at the time of implementation of the project, Madhuband Washery did not serve the desired purpose. Further, the choice of the contractor was flawed, leading to delay by more than 12 years and a cost overrun of Rs.125.33 crore. Many equipment and processes were by-passed or could not be put to operation properly.

The capacity remained grossly underutilised and supply of the final product to steel plants stopped, this defeating the purpose for which it was set up.

3.8 Recommendations

(a) The Company needs to carefully review its project implementational abilities so as to ensure that the envisaged targets are met;

(b) The Company needs to review its policies with regard to selection of bidders so that its interests are protected;

(c) Efforts at more efficient utilisation of the washery are necessary together with a review of the overtime policy of the Company.

The review was issued to the Ministry in October 2004; its reply was awaited (March 2005).

CHAPTER : IV

Western Coalfields Limited

Information Technology Audit of Asset Accounting System

Highlights

The Asset Accounting System (AAS) in the Western Coalfields Limited (WCL) was not an independent system in itself. Though AAS was only a module forming part of Financial Accounting System (FAS), it was not linked to FAS for data uploading.

(Para 4.5.1)

The system allowed for direct data entry in the field of "opening depreciation till date" instead of calculating it by using the date of capitalization and the rate of depreciation. Accordingly, depreciation of Rs.2.47 crore was overcharged. In absence of application logs, it was not possible to trace when and who made the data entry. There were no access controls for making changes in entries in Asset Register or for changing the source code.

(Para 4.6.1)

WCL changed the accounting policy towards amortization of Prospecting, Boring and Development (PB&D) expenditure in 2001-02. But the changes were not incorporated in the application with the result that each Area charged this expenditure at a rate that they understood to be correct. This showed that WCL had no established Change Management Protocol, rendering the application vulnerable to misuse.

(Para 4.7.1)

At Umrer Area of WCL, PB&D expenditure was being written off in a manner which neither conformed to the old nor to the new policy, due to which, depreciation to the tune of Rs.39.95 lakh was undercharged during the year 2002-03.

(Para 4.7.2)

At Nagpur Area of WCL, the application calculated the depreciation such that when an asset was added after 15th of a month, no depreciation was charged. Accordingly, depreciation was undercharged to the extent of Rs.29.17 lakh during three years 2000-01 to 2002-03.

(Para 4.7.3)

4.1. Introduction

4.1.1 The Western Coalfields Limited, Nagpur (Company) is one of eight subsidiaries of the Coal India Limited (CIL). The Company is engaged in extraction and sale of coal from 80 mines situated in Maharashtra and Madhya Pradesh. As on 31 March 2003, the Company had 10 Areas at various places in these two states.

4.1.2 The production and sale of coal during the last five years were as follows:

	1998-99	1999-2000	2000-01	2001-02	2002-03
Production (in million tonnes)	31.75	33.86	36.20	37.01	37.82

Sales (Rs. in crore)	2435.72	2600.55	2685.37	3015.84	3199.76

4.2. Organisational set-up

The Company has a System Department headed by the Chief General Manager (Systems), who is assisted by Chief Managers, Managers and other executives at headquarters and different Areas. The System Department looks after the work of system design and programming, routine Information Technology (IT) operations, data input, database administration, initiation of purchase indents, maintenance of hardware and software and other related matters.

4.3 IT Assets

4.3.1 The Company procured computers and peripherals on hire basis. Expenditure incurred on hiring of computers and peripherals during the three years ended March 2003 was Rs.1.29 crore, Rs.1.42 crore and Rs.1.50 crore respectively. The Company also owned IT assets valuing Rs. 77.20 lakh as on 31 March 2003.

4.3.2 The table below indicates the details of the infrastructure available with the Company:

S.No.	Server	Date of installation	Place	Purpose
1	Rise (1)	September 2002	Headquarters	Payroll, Employees information
2	Intel (6)	May to September 2000	Headquarters and five Areas	Sales Accounting
3	Intel (18)	September 1999 to January 2000	Headquarters, six Areas, 10 Regional Stores, Central Store	On line Material Management System and routine

The Company had following application systems in use:

(i) Payroll System

(ii) Sales Management System

(iii) Financial Accounting System

(iv) On line Material Management System

The operating system available was UNIX with RDBMS[1] ORACLE 7 and 8 and the programming languages in use were PL/SQL, FOXPRO and COBOL.

4.4. Scope of Audit

4.4.1 For assets accounting, the Company has a computerized Asset Accounting System in COBOL/ORACLE at its headquarters and 10 Areas[2]. An Information Technology audit of the Asset Accounting System was conducted during the month of August 2003 in seven Areas (Chandrapur, Ballarpur, Wani, Pench, Kanhan, Umrer and Nagpur) and the headquarters of the Company.

4.4.2 The scope of audit was to examine whether the system had been designed to maintain data integrity and to evaluate the reliability and effectiveness of the system.

[1] ***Relational Data Base Management System***

[2] ***Chandrapur, Ballarpur,Wani, Pench, Kanhan, Umrer, Nagpur, Majri,Wani North and Pathakheda***

Further, the operational performance of the system software was checked by feeding dummy data into the system and comparing the output with manually calculated results.

4.4.3 The findings of Audit are discussed in succeeding paragraphs:

4.5. Not linked to Financial Accounting System

The Asset Accounting System (AAS) was not an independent, self-contained system in itself. Though AAS was only a module forming part of Financial Accounting System (FAS), it was not linked to FAS for data uploading. It had been developed as a stand-alone program except in one Area (Nagpur) which was connected with Local Area Network (LAN), and put to the limited purpose of calculating annual depreciation and printing Asset Register. The transactions relating to assets acquisition, transfer, disposal, etc. were being carried out on batch processing mode. For receipts, issues and transfers, etc. of assets, a journal voucher was prepared which acted as an interface and involved duplication of work. The Ministry stated (January 2005) that the system was being modified to avoid duplication of work.

4.6. Deficient access control and absence of audit trail

4.6.1 The Company provided depreciation at the rates specified in Schedule XIV of the Companies Act 1956 on straightline method. It was seen that an expenditure of Rs. 8.20 crore was capitalized on 10 June 1997. As per the Company's accounting policy, total depreciation till the year 2002-03 worked out to Rs.2.46 crore at a rate of five per cent per annum whereas the application showed a sum of Rs.4.93 crore as depreciation. Audit analysis revealed that the system allowed for direct data entry in the field of "opening depreciation till date" instead of calculating it by using the date of capitalization and the rate of depreciation. In absence of application logs, it was not possible to trace when and who made this data entry. It was found that there were no access controls for making changes in entries in Asset Register or for changing the source code. There was no system password and the application password was also not kept secret. Thus, depreciation of Rs.2.47 crore was charged in excess and profit and tax liabilities were accordingly understated.

4.6.2 The Management/Ministry stated (September 2003/January 2005) that it was due to adjustment made with regard to negative assets at the time of transfer of assets from Nagpur Area in 1995. The reply was not relevant in view of the fact that the Umrer Area was separated from Nagpur Area in 1995 and assets under reference were capitalized only in the year 1997-98. The Ministry added that the Company was in the process of removing the deficiencies in respect of access to application programme.

4.7 *Deficient change management procedures*

4.7.1 In 2001-02, the Company changed the accounting policy towards amortization of Prospecting, Boring and Development (PB&D) expenditure. But the changes were not incorporated in the application with the result that each Area charged this expenditure at a rate that they understood to be correct and there was no uniformity. Nagpur and Pathakheda Areas of the Company were still following the old policy. This showed that the Company had no established Change Management Protocol, rendering the application vulnerable to misuse.

4.7.2 Audit also observed that at Umrer Area, the PB&D expenditure was being written off in a manner which neither conformed to the old nor to the new policy. Due to this,

depreciation to the tune of Rs.39.95 lakh was undercharged during the year 2002-03. While accepting the lack of uniformity in amortising PB&D expenditure, the Management stated (September 2004) that all the Areas started implementing the uniform method from the year 2003-04. The Ministry added (January 2005) that a standard Oracle based system was being implemented, which would ensure the uniformity of the computation and procedure.

4.7.3 If an asset is added/disposed of during the year, the depreciation is provided on monthly pro-rata basis with reference to the month of addition/disposal. At Nagpur Area, the application calculated the depreciation such that when an asset was added in a month on or before 15th day of a month, depreciation for the whole month was charged and if the asset was added after 15th of a month, no depreciation was charged. This resulted in undercharging of depreciation to the extent of Rs.29.17 lakh during three years 2000-01 to 2002-03. The Management stated (August 2003) that at the time of introduction of ORACLE in the year 2000-01, this aspect of accounting was missed inadvertently. The Ministry added (January 2005) that necessary changes have been made in the system and rectification made in the accounts for the year 2003-04.

4.8 Conclusions and Recommendations

4.8.1 The Asset Accounting System served the limited purpose of calculation of depreciation and generation of asset register. It was not a complete system in itself and not linked to the Financial Accounting System. It was running in different languages at different units with end-users having unlimited authority to effect changes in module and alter entries in asset register. Further, no built-in checks were developed in the system to ensure data integrity and compliance of accounting principles. This resulted in overcharging and undercharging of depreciation to the extent of Rs.3.16 crore, vitiating the financial statements of the Company.

4.8.2 There is a need to integrate the Asset Accounting System with Financial Accounting System in all the Areas. The Company also needs to make necessary access controls to avoid unauthorised changes in Assets Register or the source code, and to ensure uniformity in computation.

MINISTRY OF CONSUMER AFFAIRS, FOOD AND PUBLIC DISTRIBUTION

CHAPTER : V

Food Corporation of India

Export of foodgrains

Highlights

The Government of India permitted the Food Corporation of India (FCI) to offer wheat and rice for export to liquidate excess stocks in the central pool. Accordingly FCI issued 19.71 million MT of wheat and 13.53 million MT of rice was issued for export. The economic cost and sale value of the quantity of wheat and rice issued for export were Rs.33,927 crore and Rs.19,792 crore respectively.

(Para 5.1)

The increased procurement of wheat and rice was not justified both from the point of view of production as well as off take and led to heavy accumulation of stocks in central pool. Consequently 33.24 MMT of wheat and rice was issued for export during the period from November 2000 to February 2004.

(Para 5.3)

The Ministry fixed lower export price for wheat due to incorrect adoption of economic cost and higher carrying cost. This resulted in additional subsidy burden of Rs 1608.63 crore.

(Para 5.4.1)

The sale price fixed for export of wheat and rice was on ex-FCI port godown. As a result the exporters lifted the foodgrains from the godowns of their choice situated in far flung places, irrespective of the fact that sufficient stocks were available in nearby godowns with reference to the designated ports from where export took place. In the process, FCI had to incur Rs.516.36 crore towards freight charges in respect of 22 districts test checked in audit.

(Para 5.4.3)

FCI reimbursed transportation charges of Rs.105.27 crore without obtaining the prescribed documents as directed by the Ministry.

(Para 5.5.2)

The exporters to Bangladesh were given an unintended benefit of Rs.44.25 crore in transportation of foodgrains by rail.

(Para 5.5.3)

The exporters were given undue benefit of Rs.20.20 crore by allowing them to lift the foodgrains after price revision.

(Para 5.5.4)

There were many deficiencies in export operations, besides non-compliance of instructions of the Ministry such as reimbursement of road transportation charges without

proper proof of payment, giving allowances when it was not required, extending undue benefit to exporters, issue of foodgrains at pre-revised rates after price revision etc. There were also instances of irregularities, that is, non-recovery of penalties, non-submission of export documents, doubtful cases of exports and non-existence of adequate internal control mechanism.

(Paras 5.6.1 to 5.6.4)

Internal Audit was not entrusted/involved for checking the documentation through out the export operations contributing to many omissions and commissions.

(Para 5.10)

5.1 Introduction

The Food Corporation of India (FCI) was established in the year 1965 and entrusted with the purchase, storage, movement, transport, distribution and sale of foodgrains and foodstuffs. FCI was the nodal agency through which the Government of India (GOI) implemented its food policy, the objectives of which were to

(i) safe-guard the interests of farmers by effective price support mechanism,

(ii) distribute foodgrains and sugar throughout the country at uniform issue prices and

(iii) maintain satisfactory levels of operational and buffer stocks to ensure nation's food security.

The Government of India fixed (October 1998) the norms for the quantity of minimum stocks of wheat and rice to be held at the beginning of every quarter in the Central Pool under the buffer stocking policy, which ranged from 15.8 Million Metric Tonne (MMT) to 24.3 MMT. As against this, the stock position as on 30 September 2000 was 40.06 MMT. In view of the burgeoning stock position, the Ministry of Consumer Affairs, Food and Public Distribution (Ministry), Government of India, submitted (September 2000) a proposal for consideration of the Cabinet Committee on Economic Affairs (CCEA) for "Revamping of Public Distribution System (PDS) – Measures to improve off take of foodgrains". A Group of Ministers constituted, to consider the above proposal, decided (October 2000), inter-alia, that FCI might be permitted to offer wheat for export at a price equal to economic cost minus two years' carrying cost but not lower than the Central Issue Price (CIP) for 'below poverty line' (BPL) category. The issue of wheat for export commenced in November 2000.

FCI was also permitted to issue rice for exports in December 2000 and wheat for export of wheat products in December 2001.

Accordingly, FCI issued 19.71 MMT of wheat and 13.53 MMT of rice for exports during November 2000 to February 2004. The economic cost and the sale value of the quantity of wheat and rice issued for export (based on the highest sale price obtained in a year) were Rs.33,927 crore and Rs.19,792 crore respectively involving a subsidy burden of Rs 14,135 crore being the difference between economic cost and sales realisation

5.2 Scope of Audit

The objective of the review was to examine the entire scheme of export of foodgrains to ensure whether the financial interest of FCI/Government was safeguarded while

liquidating the excess stocks. The review also covered the irregularities as well as deviations from the instructions issued by GOI for export of foodgrains during the period from November 2000 to February 2004. Audit test checked during December 2003 to March 2004 the records relating to exports in 57 District Offices in 16 Regions involving a quantity of 17.23 MMT out of a total of 33.24 MMT of wheat and rice issued for export. The findings of Audit are detailed in the following paragraphs.

5.3 Factors contributing to export of foodgrains:

5.3.1 Heavy accumulation of stocks.

The table below gives the stock levels of wheat and rice as on the first day of January, April, July and October of the years 1998 to 2002 under the Central Pool as against the minimum stock level under Buffer Stocking Policy.

(Quantity in MMT)

Year	1st January		1st April		1st July		1st October	
	Rice	Wheat	Rice	Wheat	Rice	Wheat	Rice	Wheat
1998	11.49	6.76	13.05	5.08	12.04	16.48	8.96	15.24
1999	11.69	12.70	12.16	9.66	10.56	22.46	7.74	20.31
2000	14.72	17.17	15.72	13.19	14.49	27.76	13.21	26.85
2001	20.70	25.04	23.19	21.50	22.75	38.92	21.45	36.83
2002	25.62	32.42	24.91	26.04	21.94	41.07	15.77	35.64
Minimum stock under buffer norm	8.40	8.40	11.80	4.00	10.00	14.30	6.50	11.60

It could be seen from the above table that the stock levels gradually started piling up from early 1999 and reached a level of 42.25 MMT in July 2000. This included 24.90 MMT with FCI against storage capacity of 27.10 MMT available.

The mounting stocks of rice and wheat with FCI coupled with serious storage problem that was expected to crop up during the khariff procurement season commencing from October 2000 forced the Government of India to take a decision to export foodgrains (October 2000).

The Management confirmed (November 2004) the audit observations.

5.3.2 Reasons for heavy accumulation

The table below gives the details of production, procurement and off-take of wheat and rice from 1998-99 to 2002-03:

Year	Production (MMT)			Percentage increase in production	Procurement (MMT)			Percentage increase in procurement	Procurement as a percentage of production	PDS & Schemes Offtake (*) (MMT)		
	Rice	Wheat	Total		Rice	Wheat	Total			Rice	Wheat	Total
1998-99	86.08	71.29	157.37		11.87	12.65	24.52		15.58	11.71	8.37	20.08
99-2000	89.68	76.37	166.05	5.52	17.31	14.14	31.45	28.26	18.94	12.27	6.24	18.51
2000-01	84.98	69.68	154.66	-6.86	19.59	16.36	35.95	14.31	23.24	10.02	5.22	15.24
2001-02	93.08	71.81	164.89	6.61	21.28	20.63	41.91	16.58	25.42	12.96	8.06	21.02
2002-03	75.72	69.32	145.04	-12.04	16.3	19.03	35.33	-15.70	24.36	17.32	14.19	31.51

(*) Excluding Open Sale and Exports

The Central Pool stock of wheat as of 1 April 1999 was 9.66 MMT against a minimum stock requirement of 4 MMT under the buffer norms. The procurement during the year 1999-2000 (the major part of procurement is done during April-October) was 14.14 MMT. Against this, the off-take for PDS and centrally sponsored schemes during the same period was only 6.24 MMT. As a result, the stock position at the beginning of April 2000 rose to 13.19 MMT, that is, more than thrice the minimum stock requirement under the buffer norm. The production of wheat in the year 2000-2001 was 69.68 MMT as compared to 76.37 MMT in the preceding year. Despite the fall in production and a comfortable buffer at the beginning of the year, the procurement during the year 2000-2001 was 16.36 MMT, as against 14.14 MMT in the previous year. The excess procurement was not justified also from the point of view of PDS off-take, which fell to 5.22 MMT in 2000-01 from 6.24 MMT in the previous year. This resulted in further piling up of stock to 21.50 MMT by 1 April 2001, fives times the buffer norm of four MMT.

Similarly in the case of rice, the stock as of 1 October 1999 was 7.74 MMT against a minimum stock requirement of 6.50 MMT under the buffer norm. The production of rice during the year 1999-2000 (October – September season) was 89.68 MMT as compared to 86.08 MMT in 1998-99. Though the production increased by only 3.60 MMT and despite comfortable buffer stock at the beginning of the season, the procurement during 1999-2000 was increased to 17.31 MMT from 11.87 MMT in 1998-99. The substantial increase in procurement was also not justified from the off-take point of view, as the off-take in 1999-2000 was only marginally higher at 12.27 MMT as against 11.71 MMT in 1998-99. This increased the stock position at the beginning of the next procurement year (October, 2000) to 13.21 MMT, that is, twice the minimum stock of 6.50 MMT under the buffer norm.

Thus, the increase in procurement of wheat in 2000-2001 (April-March) and of rice in 1999-2000 (October-September) was not justified either from the point of view of production (support to the farmer) or from the point of view of off-take (PDS needs). This led to piling up of stocks and the Government of India perforce had to resort to export of wheat and rice.

Deficiencies in the pricing of wheat and wheat products for export are discussed in succeeding paras.

5.4.1 Fixation of lower export price for wheat

The Group of Ministers (GOM) decided (October, 2000) that wheat be offered for export at a price equal to the economic cost minus two years' carrying cost but not lower than the Central Issue Price (CIP) for BPL category. The Ministry adopted Rs.8300 per MT and Rs.2204 per MT, being the estimated economic cost for 2000-01 and the related carrying cost respectively which was worked based on the revised method of allocation of distribution costs suggested by Expenditure Reforms Commission (ERC). On the basis of recommendations of ERC, the issue price of wheat was arrived at Rs.3892, which was stepped up to Rs.4150, that is the BPL price the minimum rate at which the wheat was to be offered for export. As such the wheat for export was issued at Rs.4150 during November 2000 to March 2001.

It was observed that the recommendations of ERC (July 2000) were intended for arriving at the realistic economic cost, which the consumers under PDS ought to pay and did not have approval of the Government of India. Even the subsequent approval of the Government of India (July 2002) was categorical that the revised methodology was to arrive at a realistic economic cost for the consumers under PDS and such not relevant to arrive at the issue price of wheat for export. Further, while taking the decision (October 2000) the relevant available costs were the economic cost of 1999-2000, that is, the costs of immediate preceding year and carrying cost of two years referred would be the carrying costs of 1999-2000 and 1998-99. Accordingly, the issue price based on the criteria decided by the GOM would work out to Rs.6044 per MT (Rs.8875 minus Rs.1445+ 1386) Thus, adoption of issue price of Rs.4150 per MT for export as against Rs.6044 during 2000-01 was not in order.

The export price fixed in 2001-02 was in the range of Rs 4200 to Rs.4300 per MT as against the applicable price of Rs.5841 per MT as per the criteria of GOM and based on the economic cost (2000-01) and buffer carrying cost of the preceding two years (1999-2000 and 2000-01). Similarly, the issue prices in 2002-03 and 2003-04 (September 2003) were also lower. As a result, there was short realization of Rs.1608.63 crore on 168.69 lakh MT of wheat issued for export during the period November 2000 to September 2003. This in turn led to increased subsidy burden on the Government of India on export of wheat to the extent of Rs.1608.63 crore due to adoption of lower economic cost and higher carrying cost.

It was seen from the note submitted to CCEA, that the ERC recommendations for change in the method for working out economic cost and buffer carrying cost was to be finalised in consultation with CAG as was done in 1979 while fixing the economic cost. However, in the instant case, the issue was not referred to CAG.

The Management stated (November 2004) that the revised methodology adopted for working out the economic cost and buffer carrying cost and the fixation of the issue price of wheat for export on the revised basis would need to be commented upon by Ministry. The Ministry's reply was awaited (November 2004).

5.4.2 Incorrect Fixation of price for Wheat Products

The High level Committee (HLC) recommended (August 2001) a price of Rs.4700 per MT for issue of wheat for export of wheat products on the basis of cost details prepared by FCI and offers received from STC and three private parties. FCI projected the sale realisation including byproducts at Rs.6718 per MT whereas the roller flour mills (RFMs) and STC projected it as ranging between Rs.5205 per MT and Rs.6385.50 per MT. The cost of conversion (including profit) proposed by FCI was Rs.750 per MT, while STC and the RFMs quoted from Rs.1000 per MT to Rs.2075 per MT. The HLC, while taking note of these variations worked out the issue price of wheat at Rs.4700 per MT as given below: -

Sale realisation	Rs.6220 per MT
Less Conversion Cost	Rs.1520 per MT
Issue price	Rs.4700 per MT

The Ministry fixed (December 2001) the price at Rs. 4750 per MT after taking into account the escalation in the issue price of wheat from August 2001 to December 2001.

It was observed in Audit that the average of conversion costs quoted by parties considered by HLC worked out to Rs.1254 per MT only whereas the HLC adopted a conversion cost of Rs.1520 per MT. Even after taking into consideration the average of different variables quoted by all the parties as reasonable, the issue price worked out to Rs.4966 per MT against the issue price of Rs.4700 per MT fixed by HLC. On this basis, the extra subsidy allowed for issue of wheat for export of wheat products was Rs.266 per MT. Consequently, the extra subsidy on the quantity of 2.69 lakh MT of wheat, for export of wheat products, issued during January 2002 to February 2004 was worked out to Rs.7.15 crore.

5.4.3 Unfruitful expenditure on transportation

The sale price fixed for export of wheat and rice was on ex-FCI port godown. This facilitated the exporters to lift foodgrains from the godowns of their choice and that too, at the cost of FCI and have them delivered at the port of their choice. As a result the exporters lifted the foodgrains from the godowns of their choice situated in far flung places, irrespective of the fact that sufficient stocks were available in nearby godowns with reference to the designated ports from where export took place. For instance the foodgrains were transported from Raichur in Karnataka to Kandla port in Gujarat and from Punjab to Tuticorin in Tamilnadu. There were also cases of movement from one port town (Chennai) to another port town (Tuticorin) at the cost of FCI. In the process, FCI had to incur freight charges on unwarranted movement of foodgrains from various far-flung godowns in the country to the port town designated by the exporters.

It was observed that the implication of making available the foodgrains from whichever godown the exporters chose and move the foodgrains to the port town of their choice was not examined by the Ministry. FCI spent Rs.516.36 crore on freight charges in this process in respect of 22 districts examined in audit involving movement of 7.2 MMT foodgrains out of a total of 33.24 MMT foodgrains issued for export, which was unwarranted.

The high incidence of freight charges on inland movement also had the effect of reducing the net realization from exports, which fell below the issue rate for BPL category as seen from the table below:

(Figures Rs. per MT)

Commodity	Max. sale price for export in 2001-02	Average inland freight	Net realisation from exports	BPL issue price
Wheat	4300	738	3562	4150
Raw rice/ Boiled rice	5650/6000	699	4951/5301	5650

The Management replied (November 2004) that the BPL rates were uniform throughout the country and FCI's foodgrains were moved from the surplus States to the deficit States by payment of freight by FCI at the consignor's end. It also stated that payment of freight by FCI up to port town, which was as per the terms and conditions for issue of foodgrains for export, was an integral part of the export operations and no such inference could be drawn thereon.

The Management's reply is not tenable as permitting the exporters to lift the foodgrains at their discretion and involving heavy freight charges at the cost of FCI was not financially prudent and cannot be justified equating the same with the movement of foodgrains from surplus States to the deficient States in fulfilment of the food policy and to supply foodgrains at uniform prices especially to weaker sections of the country. Further the PDS nominee in Karnataka or Tamilnadu had no justification to demand stock in Punjab when sufficient stocks were available in the nominated depots in their States. The fact that the net realization from export was less than the BPL price has not been denied.

Thus the decision of giving a free hand to the exporters to lift the foodgrains from the godowns of their choice not only resulted in unwarranted movement of foodgrains entailing heavy expenditure on freight charges but also resulted in issuing the foodgrains below BPL rates in violation of instructions of GOM according to which exports were to be effected at BPL rates.

5.5 Deficiencies in sale operations

5.5.1 Exclusion of FCI from export operation

The Management proposed (November 2000) to the Ministry that FCI could undertake the export operations directly or through private parties in case the nominated Public Sector Undertakings engaged middlemen for export operations. The Government while deciding (November 2000) that the export of foodgrains would be undertaken by the three Public Sector Undertakings viz., STC, MMTC and PEC, stated that a view on engaging FCI in export operations would be taken after watching the performance of the three Public Sector Undertakings. However, FCI was not considered for export operations although the other Public Sector Undertakings engaged middlemen for export and private parties were permitted to export foodgrains on their behalf. FCI could have also been entrusted with export operations for attaining/adding economy and efficiency,

considering the long experience it had in port operations with adequate manpower for the procurement and distribution of foodgrains.

The Management stated (November 2004) that the Ministry would furnish a suitable reply. Ministry's reply was awaited (November 2004).

5.5.2 Reimbursement of Road Transport Charges without proper documents – Rs.105.27 crore.

The Corporation, while reimbursing road transport charges to the exporters was required to obtain proof of movement of stocks into the port towns as per directions of the Ministry. FCI Headquarters, in turn, directed its field offices to insist on truck chits/goods receipts and cash receipts for freight along with certificates from licensed customs-clearing agents giving details of trucks, commodity, quantity received and payment released on behalf of the party at port towns. However, the field offices reimbursed transportation charges of Rs.105.27 crore without obtaining the prescribed documents duly authenticated in respect of 15.46 lakh MT of foodgrains in eight districts in three regions. As such the directions of the Ministry for reimbursement of transportation charges based on actuals were not complied with and the correctness of the expenditure could not be vouched-safed in audit.

The reply of the Ministry/ Management was awaited (November 2004).

5.5.3 Undue benefit of Rs. 44.25 crore to exporters for foodgrains exported through rail to Bangladesh

The Post Delivery Expenses (PDE) allowed to exporters ranged from Rs.1700 per MT to Rs.3850 per MT in respect of rice and from Rs.1175 per MT to Rs.2850 per MT in the case of wheat and were uniform irrespective of the destination, that is, the distance involved in export of foodgrains to various countries. No exercise was done to arrive at realistic post delivery expenses that the exporters would be incurring. The Government also allowed uniform discount for export by both rail and sea. It was observed that in the case of exports to Bangladesh by rail, the loaded rakes were directly moved from FCI inland godowns to various destinations in Bangladesh. FCI paid the freight charges from its inland godowns to the final destination and recovered the differential rail freight between the actual rail freight incurred and the rail freight from inland godown to the designated Indian rail port at border with Bangladesh, from the exporter. This differential freight recovered from the exporter worked out to approximately Rs.30 per MT.

The allowance towards PDE ranging from Rs.1175 per MT to Rs.3850 per MT was extended in respect of foodgrains issued for export and transported by rail to Bangladesh as against only Rs.30 per MT borne by the exporter. Thus the reimbursement of Rs. 44.25 crore towards PDE, worked out on the basis of the minimum rate of Rs.1175 per MT for wheat and Rs.1700 per MT for rice on a quantity of 0.93 lakh MT of rice and 2.51 lakh MT of wheat directly moved by rail to Bangladesh, was not in order.

The Management stated (November 2004) that the Ministry while deciding to allow uniform discount for export by rail and sea appeared to have approached the subject matter pragmatically considering the distances involved from Indian sea port to farthest countries like Russia, USA, Egypt, Indonesia, South Korea, South African countries, London, Germany, Italy (to name a few) and nearer countries like Srilanka and Bangladesh where lead involved was less. The Management further stated that to allow

different PDE to different countries based on distances or linked by rail as well as sea, would result in a spectrum of different discounts (PDE) monitoring of which would be a herculean task. The reply is not valid as in the context of large differential in the rate for Bangladesh between Rs.30 per MT and Rs.1175 per MT, the Ministry should have weighed the cost benefits by notifying the rates, which could have resulted in saving of Rs.44.25 crore in the export of foodgrains by rail.

5.5.4 Loss of Rs.20.20 crore due to issue of foodgrains at pre-revised rates after price revision

In the case of issue of foodgrains for PDS, whenever issue prices were revised, the revised prices were charged for quantities issued from one week prior to the date of revision. However, in the case of exports, the exporters were allowed the benefit of pre-revised lower prices even for quantities lifted after date of price revision. Considering the primary objective of liquidating the surplus stocks on priority, the extension of benefit of pre-revised price to the exporters for quantities lifted after price revision was a deviation from the general principles of prudence followed by the Corporation for domestic issues. Resultantly, FCI suffered a loss of Rs.20.20 crore on account of extending such concession to exporters on a quantity of 8.58 lakh MT of wheat and rice.

The Management stated (November 2004) that the Ministry would offer its comments on this decision. Ministry's reply was awaited (November 2004).

5.5.5 Extension of Export price for lustre lost wheat purchased under Open Market Sales Scheme-(Domestic) (OMSS -D)

Lustre lost wheat was issued for export of wheat products only from October 2002. The District Office, FCI, Ujjain, issued (August 2002) 6613 MT of lustre lost wheat to M/s. Dewas Flour Mills and M/s. Sanghvi Flour Mills under OMSS (D). The issues thus made were only for sale under OMSS (D). Subsequently when the Ministry ratified supply of lustre lost wheat from February 2002 to September 2002 for export of wheat products retrospectively, the wheat issued to the above parties was also categorized as if issues were for export and accordingly export subsidy of Rs.0.95 crore was released to the parties. As the Ministry's ratification was only for those lustre lost wheat stocks issued prior to 1 October 2002 for wheat products export, application of export price to stocks issued under OMSS (D) resulted in extending unintended concession of Rs.95 lakh and as such was irregular.

The field office (Regional Office, Bhopal) of FCI stated (September 2004) that the Region never recommended reimbursement of PDE and inland transportation charges in the instant case but the party directly approached FCI, Headquarters/Ministry and got the approval of the same. The FCI Management simply forwarded (November 2004) the reply without offering any specific remarks. The Ministry's reply was awaited.

5.5.6 Loss due to issue of wheat at reduced rates applicable for lustre lost wheat for exports – Rs.1.11 crore

The District Office, Bikaner, issued 31,738 MT of wheat at the reduced rate of Rs.3,960 per MT applicable to lustre lost wheat though the stocks were not lustre lost as evident from Independent Consignment Certification Officer reports. This resulted in a loss of Rs.1.11 crore being the difference between the rate of good wheat and lustre lost wheat.

The Management stated (November 2004) that reply was awaited from concerned Regional Office.

5.6 Irregularities in the export transactions

5.6.1 Non-recovery of penalties due to engagement of private middlemen by Public Sector Undertakings:

The exporters were required to furnish a Bank Guarantee for the difference between the OMSS (D) price and the export price charged. In the event of failure to fulfill the export obligations and furnish the required proof thereof within the stipulated time, FCI would encash the Bank Guarantee. Thus the Bank Guarantee could be used as a deterrent device against malpractices. The Public Sector Undertakings were, however, exempted from submission of Bank Guarantee and instead they were required to submit an indemnity bond. At the same time, the Public Sector Undertakings were also permitted to engage private parties as agents and middlemen for export operations. As a result, the benefit of exemption from furnishing Bank Guarantee got extended to these private parties also. The indemnity bond furnished by the PSUs was not a suitable substitute for Bank Guarantee as it did not facilitate timely realization of dues in cases of doubtful transactions. Resultantly, FCI failed to levy or collect any penalty from such parties in the absence of Bank Guarantees.

The export documents such as export contracts, invoices, bills of lading and bank realisation certificates were received in the names of the private parties on behalf of the Central and State Public Sector Undertakings. There were several cases of doubtful transactions as discussed in the following paragraphs.

5.6.2 Non-submission of export documents

As per the terms and conditions for issue of foodgrains for export, the exporters were required to submit the following documents after completion of exports: -

(i) H Form

(ii) Bill of lading

(iii) Invoice

(iv) G.R. form

(v) Shipping bill

(vi) Bank Realisation Certificate

These documents were to be submitted within a period of 45 days for wheat and 90 days for rice from the date of issue of foodgrains, failing which the Bank Guarantee furnished by the exporters would be encashed.

It was observed that the exporters did not submit to FCI the entire set of documents, that is, submitted only one or more of the above documents in respect of 9.72 lakh MT of wheat and 0.04 lakh MT of wheat for wheat products and 4.93 lakh MT of rice issued from 23 District Offices in seven Regions of FCI. No export documents were furnished for verification to audit either by the District Office or by the Regional Office in respect of 3.83 lakh MT of wheat and 0.91 lakh MT of rice issued from 18 District Offices in four Regions.

As per the instructions of FCI Headquarters, New Delhi, in cases of lifting of wheat/rice stocks by the parties, for export to Bangladesh through barges, the proof of export was to be substantiated by the documents from the office of Inland Water Transport Corporation, Kolkata. It was observed that in respect of 17178.376 MT of rice issued from Andhra Pradesh region for export through barges, Inland Water Transport Corporation, Kolkatta did not authenticate the documents. However, the unauthenticated documents submitted by the party were accepted in violation of the FCI Headquarters instructions.

5.6.3 Non-submission of original documents

The exporters were required to submit the export documents in original. A test check in Andhra Pradesh region revealed that the exporters did not submit the original documents in respect of export of 2.71 lakh MT of rice and 1.41 lakh MT of wheat. Failure to insist on original documents was not in order as it could lead to possible misuse by the exporters.

5.6.4 Doubtful cases of Export

Considering the ex-FCI godown export rate which was far below the economic cost, the Ministry stated (February 2001) that it was essential for the Corporation to ensure that the rice offered for export was actually exported and was not recycled in the local market. For this purpose, it was directed that a senior officer not below the rank of Senior Regional Manager was required to verify the documents to check forging and to ensure that the rice issued by FCI was only exported. However, the required checks at Senior Regional Manager level were not exercised as is evident from the following:

(i) The dates of shipping bill/bill of lading for export of 19,596 MT of wheat, 715 MT of wheat products and 8,782 MT of rice issued from Karnataka, Andhra Pradesh, Tamilnadu, Punjab and Gujarat regions related to the period prior to lifting of stocks from FCI godowns. The customs authentication of shipping bills was made after the bill of lading date in respect of 8,082 MT of wheat products (South Zone and West Zone)

(ii) The shipping bills submitted by the exporters in respect of 1.36 lakh MT of rice in 26 cases of issues for export from Karnataka, Andhra Pradesh and Haryana regions indicated origins other than the actual origin of the stocks lifted as per the records of FCI.

(iii) The names of the vessels mentioned in the bills of lading and the corresponding shipping bills were different in respect of 8,303 MT of rice issued from Karnataka, Andhra Pradesh and Tamilnadu regions.

(iv) FCI received reports that the exporters of Basmati rice were submitting the export documents, pertaining to Basmati rice, which they had already exported, against the stocks issued by FCI to comply with export formalities. In order to prevent this malpractice, FCI issued instructions (December 2001) to incorporate a clause indicating "non-Basmati/non-scented rice" in all bills of lading. It was observed that the documents submitted for 8,833 MT of rice issued from Tamilnadu (3729 MT) and Karnataka (5104 MT) regions did not have the stipulated clause. Thus the field offices failed to comply with the instructions of FCI headquarters intended to prevent possible misuse of documents by the exporters.

(v) As against 12,795 MT of AP rice issued from Andhra Pradesh Region for exports, the exporters submitted documents in respect of PR 106 variety, which was of Punjab origin.

(vi) In respect of 3,675 MT of rice and 1,025 MT of wheat relating to crop year 2001-02 issued from Andhra Pradesh region, the exporters submitted documents indicating different crop years that is, 2000-01 (175 MT of rice), 2002-03 (3500 MT of Rice) and 2002-2003 (1025 MT of wheat).

(vii) FCI issued boiled rice for exports with a maximum broken percentage of 16 whereas the bills of lading received for 8,065 MT of boiled rice in Tamilnadu and Andhra Pradesh regions indicated the presence of 20 and 25 per cent brokens. This showed that the stocks actually exported in such cases were not FCI stocks.

(viii) The exporters of wheat products were required to export only on CIF basis as per the Ministry's instructions (December 2001). However in respect of 4467 MT of wheat issued for export of wheat products, the export was on FOB basis which was contrary to the instructions of the Ministry.

A few specific instances of submission of doubtful/forged export documents by the exporters are enclosed in the annexure-2 as case studies.

5.7 Non-recovery of Overtime Allowance– Rs.1.72 crore

The terms and conditions governing the sale of foodgrains for exports inter alia provided that FCI depots would observe normal working hours for delivering stocks to the exporters. In exceptional circumstances, when some work was required to be done in extra working hours, FCI would charge exporters all extra expenses as might be applicable. However overtime allowance of Rs.1.72 crore incurred on export operations in 13 District Offices of five Regions was not recovered from the exporters in deviation of the agreed terms.

5.8 Non-collection of sales tax on gunnies – Rs.15 lakh

As per FCI Headquarters instructions, sales tax on gunnies in case of wheat exported in bulk was to be collected from all parties at the rates prevailing in the respective States from where exports took place. FCI, Rajasthan and Punjab regions did not collect the sales tax on gunnies to the tune of Rs.15 lakh on the stocks issued to the exporters.

5.9 Lack of control by FCI in obtaining Railway Receipts in favour of the parties

The stocks despatched to port towns for export should be in the name of the concerned port District Office of FCI. However, several rakes despatched from up North were in the name of the exporters themselves. FCI Headquarters instructed (October 2002) its field offices that the quantities despatched to port towns for export purposes were to be accounted for at the despatching ends and the Railway Receipts were to be obtained in the name of the exporters at the despatching ends themselves. This was not in line with the instructions issued by the Ministry directing FCI to institute suitable mechanism to safeguard against diversion of stocks to the domestic market. It was also directed that the recipient port districts (consignee) should send monthly statements to the respective despatching Districts/Regions (consignors) indicating the receipt of foodgrains for export purposes at the respective port towns. However, the port District Offices of South Zone did not send any such statements to the despatching ends. As a result, FCI could not

ensure the receipt of foodgrains rakes despatched from other centres at these port towns nor that the same stocks were actually exported.

5.10 Internal Audit

An independent Internal Audit wing works in FCI right from the Corporate level down to the District Office level. Considering the amount of subsidy involved in export transactions and the complexities in monitoring the transactions such as scrutinizing export contracts, allotments, issues, accountal, verification of export documents and release of bank guarantees, the Corporation could have entrusted the work relating to the verification and reconciliation of the documents at all levels to Internal Audit. FCI did not envisage this internal check system while commencing the export operations (November 2000). Only in May 2002, the HLC decided that all the export transactions were to be audited and reconciled by internal audit. FCI field offices did not implement even this decision and no internal audit report on export transactions was made available to audit except in Andhra Pradesh and Maharashtra regions. Thus, lack of inadequate internal controls and appropriate role for internal audit in reviewing the export transactions resulted in various omissions and commissions referred to above.

5.11 Conclusions:

(i) There was heavy procurement of wheat and rice neither justified from production point of view nor justified from off-take, leading to unnecessary piling up of stocks much in excess of minimum stocks of wheat and rice to be held at the beginning of every quarter in the Central Pool under the buffer stocking policy. Resultantly, the Government of India had to resort to export of wheat and rice with the intention of surmounting storage problems and reducing carrying cost.

(ii) Although the Ministry fixed the issue price of wheat for exports based on the criteria laid down by the Group of Minister constituted for considering the proposal for export of wheat, but the variables adopted, namely, economic cost and carrying cost for arriving at issue price were for the purpose of arriving at the realistic economic cost which the consumers under PDS ought to pay and as such were not relevant for export of foodgrains. In the process the price fixed was lower resulting in short realisation of Rs.1608.63 crore, which led to additional subsidy burden.

(iii) The exporters adopted a policy of pick and choose in lifting foodgrains leading to avoidable inland movement of foodgrains involving heavy freight charges at the cost of FCI. The freight charges incurred in 22 districts examined in Audit worked out to Rs.516.36 crore. The high incidence of freight charges on inland movement also had the effect reducing the net realization from exports which fell below the issue rate for BPL category.

(iv) There were many deficiencies in export operations, besides non-compliance of instructions of the Ministry such as reimbursement of road transportation charges without proper proof of payment, giving allowances when it was not required, extending undue benefit to exporters, issue of foodgrains at pre-revised rates after price revision etc. There were also instances of irregularities, that is, non-recovery of penalties, non-submission of export

documents, doubtful cases of exports and non-existence of adequate internal control mechanism.

5.12 Recommendations:

(a) While fixing the export price for foodgrains it is desirable that clear guidelines are laid down defining various terms and conditions unambiguously to avoid extra subsidy burden to the Government of India.

(b) It is desirable that foodgrains for export should be identified as regards variety, quality and location of stocks.

(c) As issue of surplus foodgrains for exports tends to become a regular feature, it is imperative that a proper system is evolved for monitoring export operations. FCI should keep proper checks and balances in place for ensuring compliance of export commitment.

(d) Internal Audit should be entrusted with checking of documentation of export transactions.

DEPARTMENT OF DEFENCE PRODUCTION AND SUPPLIES

CHAPTER : VI

Bharat Electronics Limited

Project Implementation, Production Planning, Marketing Activities and Internal Controls

Highlights

The investment of Rs.27.40 crore in seven projects was largely idle/unproductive due to preparation of unrealistic feasibility reports, under utilisation of capacity due to unwarranted expansion, non-receipt of anticipated orders, inability to capture market and non safeguarding of its interests.

(Para 6.3)

Slow-moving and non-moving inventories amounting to Rs.155.37 crore as on 31 March 2004 were 15 per cent of the total inventories.

(Para 6.4.4)

The Company could not achieve its objective of self-reliance through indigenisation as it continued to import 73 per cent of the raw materials and components.

(Para 6.4.6)

The percentage of non-Defence sector sales where the Company faced competition decreased from 26.06 per cent in 1999-2000 to 22.85 per cent in 2003-04.

(Para 6.5.2)

The Company incurred loss of Rs.8.57 crore in taking up four products meant for civilian sector.

(Para 6.5.3)

The Company could not import raw materials with in the cut-off date prescribed by the customers. As such the customers did not reimburse foreign exchange variation claims of Rs.5.64 crore. In addition the Company also suffered loss of interest of Rs.7.95 crore due to delay in raising foreign exchange variation claims on the customers.

(Para 6.5.5)

No norms had been fixed for losses/wastages of raw materials for manufacture of major products and materials in stores/transit.

(Para 6.6.4)

There was delay in raising sales invoices from 12 to 424 days resulting in loss of interest of Rs.3.93 crore

(Para 6.6.5)

The Company's existing internal control procedures were not adequate and dynamic to keep pace with increasing business activities and change in technology.

(Para 6.6.5)

6.1 Introduction

6.1.1 The Bharat Electronics Limited (Company) was incorporated in April 1954 as a fully owned Government of India undertaking under the administrative control of the Ministry of Defence. As on 31 March 2004 its paid up capital was Rs.80 crore and the shareholding of the Government of India was Rs.60.69 crore (75.86 per cent) with the balance being held by Indian financial institutions, banks, mutual funds and the public (24.14 per cent). The Company is managed by a Board of Directors headed by the Chairman & Managing Director, and consisting of 14 Directors, of whom six are full-time Directors and the remaining are part-time Directors representing the Ministry of Defence and the customers. The corporate Head Office of the Company is at Bangalore.

6.1.2 The Company designs, develops and manufactures electronic equipment like radars, communication systems, broadcasting and telecommunication equipment and electronic components. It has nine production units at Bangalore, Chennai, Hyderabad, Machilipatnam, Pune, Taloja, Ghaziabad, Panchkula and Kotdwara. It has six Regional Offices and Marketing Centres to assist in marketing and followup of realisation of sale proceeds. In addition it has two overseas Offices at New York and Singapore which assist in procurement of material from overseas market.

6.1.3 The major customers of the Company are the three Defence Services, Department of Telecommunications, All India Radio & Doordarshan and Indian Space Research Organisation. Supplies to Defence and non-Defence customers were 77 per cent and 23 per cent respectively during 2003-04.

6.2 Scope

The review seeks to evaluate the performance of the Company in the fields of project implementation, production planning, sales and marketing and internal control during the period 1999-00 to 2003-04 (earlier years too have been considered wherever deemed necessary).

Results and recommendations of Audit are featured in the succeeding paragraphs.

6.3 Project Implementation

During the period from 1999-00 to 2003-04, the Company executed six projects involving an outlay of Rs.31.69 crore. In addition, 12 projects involving an outlay of Rs.59.21 crore were completed prior to April 1999 and were under payback period. Execution of seven projects involving Rs.42.36 crore was yet to be completed (October 2004).

Important findings in respect of some of these projects are as under:-

6.3.1 Solar Photo Voltaic Cell

The project to manufacture 22.50 lakh solar photo voltaic cells per annum was taken up (March 1994) by entering into an agreement with M/s. Rexor Corporation, USA (supplier), on the understanding that the latter would supply monocrystalline silicon wafers, important raw material for production of solar photo voltaic cells. The agreement also provided that the entire production of cells would be exported to the supplier. However, the supplier did not provide silicon wafers required for manufacture of cells. The Company did not refer the matter of non-supply of silicon wafers by the supplier to Arbitration as per terms of the agreement and instead, procured these wafers locally and

produced the cells. The production of cells ranged from 0.56 lakh (1999-00) to 11.98 lakh (2001-02) and sales within country ranged from 0.26 lakh (1999-00) to 12.26 lakh (2001-02) during the past five years ending 2003-04. Thus, the facilities created were underutilised. The project incurred loss amounting to Rs.9.74 crore during 1999-2000 to 2003-04.

The Management stated (May 2004) that the solar cells could not be exported as envisaged due to constraint of availability of raw material. The reply is not acceptable as the Company had worked out the viability of the project without considering any constraint in availability or increase in price of raw materials due to exchange rate variation or import restrictions, reduction in market price etc., leading to an un-realistic estimate regarding cost and profitability of the project. Thus, the investment of Rs.6.44 crore on the project did not yield any return.

Despite this, the Company approved (October 2003) diversification plan at an outlay of Rs.27.19 crore for setting up of facilities for manufacture of multi-crystal cells for moduling solar photo-voltaic cells, again under 50 per cent buy-back agreement with another US firm. The Company had not incurred any expenditure on the diversification plan as of March 2004.

6.3.2 IC Voltage Regulator

The project to manufacture one crore units of integrated circuits (ICs) per annum required for TV, Audio System, Telecom Switches, Computers and industrial applications completed (January 1998) at a cost of Rs.1.66 crore against the estimated cost of Rs.1.41 crore was taken up based on a projected demand of two crore units per annum, of which the Company was expected to capture 50 per cent market share. However, the Company never achieved the installed capacity of one crore ICs. The highest production achieved was only 4.30 lakh units in 2000-01.

The Management stated (June 2003) that there was a slump in the market, the project was still in the initial stages and the demand was growing. The reply is not tenable in view of the fact that BSNL* had provided 2.41 crore lines based on C-DOT technology requiring these ICs, as on 31 March 2002. Evidently the market had not slumped, but the Company had not been able to exploit the same. Moreover, during the last four years ending March 2004 the Company failed to recover its costs as unit cost of production increased from Rs.8.06 per IC to Rs.15.27 per IC, whereas sale value showed decreasing trend from Rs.5.88 per IC to Rs.5.82 per IC resulting in a loss of Rs.46.57 lakh during the above period. Thus, failure of the Company to control the cost of production led to investment of Rs.1.66 crore on the project remaining largely underutilised and not yielding any return.

6.3.3 Surface Mount Devices Project – SOT 23

The project to manufacture 1.80 crore units of Surface Mount Devices – SOT 23 per annum was completed in April 1995 at a cost of Rs.2.66 crore. The project was taken up based on an anticipated demand of three crore devices in the country. The Company envisaged (January 1994) internal rate of return of 14.76 per cent for a period of seven years and also generation of net profit from the second year of operation. However, before commencing the production, the Company entered into an agreement (February

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* ***Bharat Sanchar Nigam Limited***

1995) with M/s. Temic, Singapore/Austria which envisaged dedication of entire production facilities to them for a period of three years in the first instance and extended subsequently upto 2002-03. As per the terms of the agreement, the Company, on supply of required wafers / dice by M/s. Temic, was to assemble them by providing other necessary materials. The Company, while working out the feasibility of the project, had considered the national requirement but subsequently dedicated the plant to M/s. Temic without working out the viability and incurred a loss of Rs.51.02 lakh during the period 1999-00 to 2001-02. Thus, the very objective of setting up the project was defeated. Further, due to withdrawal of its products worldwide, M/s. Temic prematurely cancelled the agreement in December 2001 and the Company stopped production IN April 2002 for export. The Company was also not able to compete in the local market due to uncompetitive prices. Thus, the investment of Rs.2.66 crore did not yield the expected return.

The Management stated (May 2004) that it was able to sell production by recovering the direct cost. The reply is not tenable as direct material cost and labour cost only had been considered without taking into account the other direct expenditure viz, depreciation, interest on investment etc., while fixing the price.

6.3.4 Small Signal Devices Diffusion

The project to expand the capacity to manufacture small signal devices diffusion, used in the production of Transistor Outline (TO)-92 assembly, from the existing 15 crore units to 21 crore units per annum was completed at a capital expenditure of Rs.3.60 crore and production started in June 1991. The expansion project was taken up without any market survey but was based on the projections (November 1986) by the Department of Electronics (DOE). The profitability of the project was not analysed by the Company on the ground that the item was meant for in-house consumption for the production of TO-92 assembly. It was noticed that production of the item had never exceeded the original capacity of 15 crore units. The production came down from 14.80 crore units in 1996-97 to 3.39 crore units in 2003-04.

The Management stated (May 2004) that 3" wafers which were being manufactured by the Company had become obsolete and hence they had to be changed to 4" wafers and the project was taken up for this purpose, apart from expansion of the capacity. The reply is not tenable as the Company in its first phase of expansion (March 1988) of diffusion capacity from 10 crore to 15 crore units involving an investment of Rs.2.98 crore had already installed machinery to handle 3" to 5" wafers. Further, the Company in its project report for expansion of capacity from 15 crore to 21 crore units did not make any mention about the obsolescence of 3" wafers and these wafers were still being used. Thus, expansion of the capacity to 21 crore at a cost of Rs.3.60 crore was not warranted.

6.3.5 Crystal Project

The Company expanded (March 1990) its capacity to produce crystals from 10 lakh to 20 lakh units at a cost of Rs.72.18 lakh. Even before this project was completed, it was decided (November 1989) to expand the capacity to 32 lakh crystals at an estimated cost of Rs.2.90 crore which was subsequently revised (July 1992) to Rs.5.47 crore due to exchange rate variation and changed requirement of equipment. The project was, however, short-closed (December 1995) after incurring an expenditure of Rs.2.55 crore on the ground of uncertainty in the market. It was noticed that production of crystals by

the Company had come down from 13.05 lakh units (1992-93) to 4.31 lakh units (2003-04) and had never reached the already expanded capacity of 20 lakh crystals. The sales of crystals had also come down from 11.77 lakh units (1992-93) to 4.23 lakh units (2003-04). Hence, expansion of the capacity to 32 lakh crystals was not warranted.

The Management stated (June 2003) that the expansion was planned to capture the market for crystals required for colour televisions and electronic push button telephones but this could not be achieved due to changes in Government policies on imports, duties and liberalisation. The reply is not tenable as the liberalisation policy of the Government was started as early as in 1992 when the Company decided to go in for further expansion of capacity from 20 lakh to 32 lakh. The Company, instead of restricting the expansion of capacity to the originally envisaged capacity of 20 lakh units, further expanded the same and short-closed it only in December 1995. Thus, in spite of clear indication regarding liberalisation policy, the Company went ahead with its expansion programme which resulted in wasteful expenditure of Rs.2.55 crore. Evidently investment on additional capacity was an injudicious decision.

6.3.6 Coupled Cavity Travelling Wave Tube

The Ministry of Defence requested (April 1992) the Company to produce coupled cavity travelling wave tubes indigenously. In September 1994, the Ministry placed an order on the Company for supply of 10 tubes at a firm price of Rs.90.72 lakh each. The Company entered into an agreement with M/s. Thomson Tubes Electroniques, France (August 1995) for supply of the equipment, know how, training etc. for manufacture of five coupled cavity travelling wave tubes per annum and paid Rs.6.24 crore between December 1995 and October 1999 to the supplier. Meanwhile, 10 tubes were imported from M/s. Thomson Tubes Electroniques, France, at a cost of Rs.7.32 crore and supplied (March 1996 to June 1998) to the Ministry at Rs.9.40 crore. The Company received (December 1999) orders from the Ministry for five tubes and the same were supplied during April 2001 to March 2003 by manufacturing in the Company's works. No further orders were received from the Ministry.

The Management stated (May 2004) that as a cost reduction measure, Indian Air Force (end user) had reduced operational hours and hence requirement of tubes was reduced. The reply is not tenable as the Company should have created the facilities for manufacture of these tubes only after getting firm commitment from the Ministry. Thus, creation of facilities for manufacture of five tubes per annum without getting firm commitment resulted in underutilisation of the capacity created at a cost of Rs.6.24 crore.

6.3.7 Ongoing project

Smart Cards Project

The Company entered into an agreement with M/s. Unival SARL, France, in March 2002 for transfer of technology for setting up of manufacturing facilities for 2.40 crore plastic cards per annum under 100 per cent buy back agreement for a period of five years from September 2002 to August 2007. The total investment envisaged on the project was US$ 15,77,600 (capital cost US$ 13,36,400 training, raw materials etc. US$ 2,41,200). The capital cost was to be shared by M/s. Unival and the Company in the ratio 56:44 (Unival US$ 7,42,500 and BEL - US$ 5,93,900). Without insisting on/ensuring M/s. Unival's share, the Company placed (April 2002) purchase orders on them for its share of the capital equipment/raw materials and these were received in the Company between June

2002 and August 2002. But M/s. Unival failed to give their share of capital equipment and the technical know-how transfer as envisaged in the agreement. As a result the Company could not start the manufacturing facility, resulting in idle investment of Rs.4.25 crore.

The following prima facie deficiencies were noticed in implementation of the project.

(i) The equipment were to be inspected by the Company before dispatch. The Company, however, waived the inspection clause and equipment were received without inspection resulting in wrong shipment. These were pending replacement (August 2004).

(ii) Though the project was initiated as an expansion plan of M/s. Unival SARL, France, the Company never insisted on investment of the collaborator's share first.

(iii) Since M/s. Unival failed to meet their commitment, the matter was pending before arbitration since September 2003.

The Management accepted (June 2004) that the matter was pending before arbitration due to failure on the part of M/s. Unival to meet their commitment.

6.4 Production Planning

6.4.1 Capacity Determination

The Committee on Public Undertakings (COPU) in its 13th Report (1986-87) recommended that the Government should appoint suitable consultants or expert authority to determine a yardstick for assessing capacity utilisation on scientific basis. The Company appointed the National Institute for Training in Industrial Engineering (NITIE) as a consultant to undertake a study of capacity determination and labour productivity of manufacturing facilities. Based on the recommendations of NITIE, the Board adopted (September 1987) SMH* at 106.8 hours/month/direct worker (1282 hours/year/direct worker) where there was 10 per cent overmanning and 90 per cent performance. The availability of capacity in terms of SMH and its utilisation during the period from 1999-2000 to 2003-2004 are indicated in Annexure-3.

It could be seen from the Annexure that SMH output of direct labour/year improved from 1012 in 1999-2000 to 1505 in 2003-04. This should be viewed in the light of the fact that after fixation of norms in 1987, no further exercise was done to review the SMH norms even though there were changes in production facilities like automation, computerisation and modernisation. NITIE's recommendations (1987) were based on data pertaining to the period from 1981-82 to 1985-86. There was threefold increase in value of production during 1992-93 to 2003-04 despite decrease in number of employees from 18840 to 13038 during the same period.

The Management stated that considering NITIE's recommendations, the adoption of 106.8 hours by the Board was realistic. The reply is not tenable as the norm for capacity determination (106.8 hours/month/direct worker) fixed in 1987 should have been reviewed and reworked taking into account the changes mentioned above.

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* *Standard Man Hour*

6.4.2 Idle Hours in Machine Utilisation

A review of data on hours of utilisation of key machines in Bangalore Complex for a period of five years ending 2003-2004 revealed that the percentage of idle hours to total available hours ranged from 24 per cent to 29 per cent. Also, an analysis of reasons for idle hours for the year 2003-2004 revealed that the idle hours booked for want of material/work etc., accounted for 82 per cent.

There is no system to report the machine utilisation and analysis of idle hours periodically to higher management so as to monitor and exercise control over avoidable idle hours. This also amounts to non-adherence to COPU recommendation, which required that the data regarding idle hours be placed before the Board every six months. Had the idle hours been reduced by proper monitoring it would have contributed to increased productivity.

The Company did not furnish any reason for non-compliance to COPU's recommendations.

6.4.3 Rejections

A special committee constituted by the Government of India in 1984 recommended fixation of norms for rejections in both Equipment and Components Divisions and any deviations from these norms were to be examined for taking remedial action. However, no norms were fixed in respect of Equipment and Components Divisions.

The Management stated that rejections could not have norms. This reply is not acceptable as norms need to be fixed for rejections as a control mechanism in any production activity.

An analysis of rejections in Component Division of Bangalore Complex revealed that rejection ranged from 1.13 per cent to 26.43 per cent during the years 1999-00 to 2003-2004. An expenditure of Rs.16.99 crore was incurred by the Equipment Division of Bangalore Complex of the Company during this period towards rework based on the complaints from the customers. The reasonableness of the rejection/rework expenditure could not be ensured in Audit as no norms were fixed for rejections.

6.4.4 Inventory level

As against the norm fixed for holding of inventory of raw materials and components in terms of months' consumption (four months), the actual inventory held for the last five years ending 2003-04 is given below:

Year	**Raw materials and Components (in terms of months' consumption)**
1999-00	8.3
2000-01	8.8
2001-02	7.4
2002-03	4.9
2003-04	5.5

It could be seen from the above that the inventory holding exceeded the norm in respect of raw materials and components during all the years and it was substantially high prior

to 2002-03. Considering the fact that the Company's major production programme was based on firm orders and its major area of sales (strategic electronics) was not linked to vagaries of market demand, holding of inventory of raw materials much in excess of the norm was not justifiable.

Slow-moving and non-moving inventory as percentage to total inventory at the end of each year during 1999-2000 to 2003-04 is indicated in Annexure-4. A review of the non-moving and slow-moving inventory revealed that the percentage of slow and non-moving inventory to total inventory of the Company ranged from 11 to 18. As at the end of March 2004, the Company held non-moving and slow-moving inventory valued at Rs.155.37 crore constituting 15 per cent of the total inventory of Rs.1015.40 crore. Out of Rs.155.37 crore, Rs.64.46 crore worth of material remained non-moving for more than five years. In the electronics industry, with rapid obsolescence of technology, five years could be inordinately long. Thus, the Company had been holding a very high proportion of slow and non moving inventory even after writing off such inventory to the extent of Rs.31.41 crore between 1999-2000 and 2003-04.

The Management stated that the position of non-moving inventory was reviewed annually and obsolete/discarded items were written off from time to time. The fact, however, remains that the inventory of raw materials and components was much too high as compared to the norm fixed by the Company.

6.4.5 Advances to suppliers

A review of advances to suppliers revealed that out of Rs.323.90 crore outstanding as at the end of March 2004, Rs.12.97 crore was lying for more than five years. Out of Rs.12.97 crore, Rs.7.22 crore were backed by bank guarantees and the remaining Rs.5.75 crore were doubtful of recovery. The Company made provision of Rs.4.61 crore during 2003-04.

6.4.6 Efforts towards self-reliance

Towards achieving the objective of self-reliance and also to reduce cost, the Company started its indigenisation activity in the year 1989-90 by increasing the indigenous content of raw materials, components and sub-assemblies in its products. In order to give a thrust to and focus on the indigenisation programme, and to streamline the activities, a separate indigenisation task group represented by the production, standards and design, and engineering divisions was set up by the Management and guidelines were issued during 1993. However, there were no directions from the Ministry of Defence regarding the areas of indigenisation that the Company should pursue, considering the nation's strategic policy.

A review of consumption of raw materials, stores and spares and finished goods during the period 1999-2000 to 2003-04 revealed that the Company could not achieve its objective of self-reliance through indigenisation as it continued to import on an average 73 per cent of the inventory consumption and the indigenous content of the materials constituted merely 27 per cent, reflecting poor effort on the part of the Company.

The Management stated that raw materials, stores and spares and finished goods should be compared to the turnover and that there was gradual reduction in their imported cost.

The reply is not acceptable as the total imported cost is to be compared to total cost of consumption of materials and components only and not to turnover value as the turnover includes profit/NMOH* and other elements which are not comparable parameters.

In order to avoid over-dependence on collaborators on a continuous basis, the Company identified and tried to indigenise major equipment such as USFM♠ Radars, Flycatcher Radars, Reporter Radars, UHF♦ radio relay RL432 and Laser Range Finder LH30, which constituted 16 per cent to 25 per cent of the Company's turnover and claimed that the percentage of utilisation of indigenous material in each of these ranged from 56 per cent to 75 per cent.

However, this was also not fruitful as indigenous content in these products even during the year ending 2003-04 ranged only between 17 per cent and 46 per cent. Thus, the indigenisation efforts of the Company even in respect of the major equipment identified for indigenisation were not satisfactory. Hence, it is important for the Company to indigenise at least critical components in order to shield itself against any geo-political fallout like the US sanctions (1998-99) and to provide long-term product support to the customers even after the original collaborator stopped the product line.

Further, it was observed that targets fixed for indigenisation in respect of Bangalore complex were very low when compared to the volume of consumption of materials and components and achievement was also very low which ranged between 1.71 per cent (2001-02) and 9.08 per cent (1999-00). This is evidently meagre and hence fixation of target for indigenisation needed review.

The Management stated that the targets for indigenisation were fixed based on products available to be manufactured, the scope of indigenisation and indigenisation already done and hence targets would vary from year to year.

It is pertinent to note that during the year 1998-99 the Company suffered set-back in achievement of turnover targets on account of non-availability of raw materials and components due to US sanctions.

6.5 Sales and Marketing activities

The Sales and Marketing function of the Company is headed by Director (Commercial and Management Services). Sales activities are supported by the respective business unit's marketing centres and distributors. The Company has an international marketing division (IMD) for export business.

The products of the Company are classified as equipment, spares and components. Equipment are manufactured with reference to customer orders and against anticipated indents from the customers. Components and spares are manufactured for stock with reference to anticipated demand.

6.5.1 Sales Performance

The Company prepares roll-on-plan (ROP) covering, *inter alia*, despatch plan for five years besides annual budget estimates (BE). Every year the Company enters into a memorandum of understanding (MOU) with the Government of India. The sales

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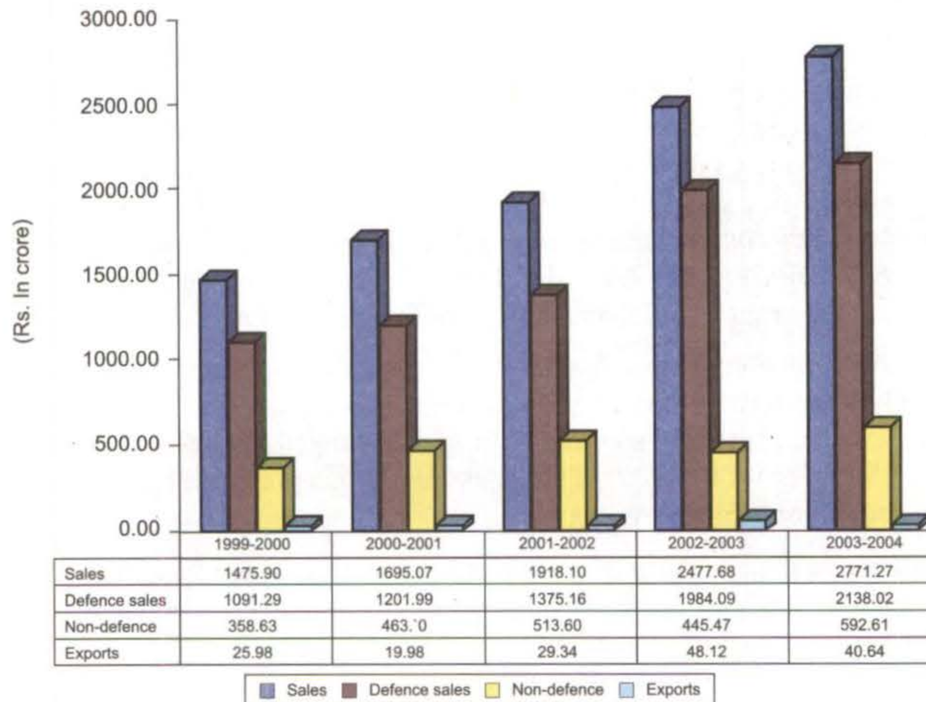
* ***Non-manufacturing Overheads***
♠ ***Updated Superfledmaus Radar***
♦ ***Ultra High Frequency***

performance of the Company mainly depended on the performance of Bangalore and Ghaziabad units. The Company was able to obtain 'excellent' ratings during the period under review (1999-00 to 2003-04)

6.5.2 Market share

The graph below gives the details of Defence Sales, non-defence sales and exports for the last five years ending 2003-04:-



	1999-2000	2000-2001	2001-2002	2002-2003	2003-2004
Sales	1475.90	1695.07	1918.10	2477.68	2771.27
Defence sales	1091.29	1201.99	1375.16	1984.09	2138.02
Non-defence	358.63	463.'0	513.60	445.47	592.61
Exports	25.98	19.98	29.34	48.12	40.64

From the above it could be seen that the Defence sector plays a crucial role in the activities of the Company and this has been increasing every year. The percentage of non-defence sector sales, where the Company faced competition, decreased from 26.06 per cent in 1999-2000 to 22.85 per cent in 2003-04. The position is alarming in view of the indications given by the Ministry of Defence during the performance review meeting (October 2000) that the Company could not afford to depend on Government (Defence) alone for getting orders and had to prepare itself for an era of free trade. Further the Company's efforts to promote export sales in line with its objective was yet to yield results as it could not progressively increase the overseas sales. The targets fixed in this regard were also very low when compared to its total sales. The targets came down from 2.76 per cent in 1999-00 to 1.69 per cent in 2003-04 and achievements with reference to sales ranged from 1.48 per cent in 2000-01 to 1.92 per cent in 2002-03.

The Management stated that the export performance was affected by factors such as changes in the global Defence scenario, depleting global Defence market and availability of suitable products for overseas customers.

The fact, however, remains that there was failure on the part of the Company to progressively increase overseas sales.

6.5.3 Market for Company's Products in non-Defence Sector

The Company had taken up various products in the civilian sector. Important observations in respect of the products test checked in audit are as under:

(i) Motherboards

In order to enter into entry-level personal computer market in India, the Company started manufacturing motherboards with Cyrix chips during the second half of 1998. Due to changed market conditions, the Company switched over (November 1999) to Intel-based motherboards (810 C and 810 E). However, due to failure to switch over to new versions in accordance with their business plan, the Company could not stay in the market. Out of 21,361 motherboards manufactured during 2000-01 to 2002-03 with Intel chips, the Company could sell 19,994 motherboards at a loss of Rs.56.51 lakh. In addition the Company also reduced during 2000-01 to 2002-03 the value of 1367 motherboards lying in stock by Rs.2.20 crore to match it with the market price. Meanwhile the Company decided (February 2002) to launch Intel 845 chip set based motherboards and produced 1877 of these during 2002-03. Out of these, the Company could sell 288 motherboards only due to limited resources to aggressively market the same and incurred a loss of Rs.12.82 lakh. In addition the Company also reduced during 2002-03 the value of 1589 motherboards lying in stock by Rs.70.78 lakh to match it with the market price.

(ii) Ophthalmic Laser System – Drishti - 1064

The Company took up (February 1998) production of Ophthalmic Laser System – Drishti – 1064 anticipating demand from Government/Private hospitals. Even before stabilisation, the Company undertook commercial production of 30 systems at a cost of Rs.1.58 crore upto 2002-03. The Company was able to sell only five systems from April 2000 to March 2004 and realised Rs.25.90 lakh only resulting in loss of Rs.1.32 crore.

The Management attributed (March 2004) the entry of better products from imported sources for the dismal sale of the product. Thus, inability of the Company to face competition both technically and commercially from its competitors resulted in a loss of Rs.1.32 crore and forced the Company out of the market for the product.

(iii) Fish Finders

The Company, by acquiring technology from Electronic Research and Development Centre of India, took up (1997-98) the manufacture of 400 Integrated Fish Finder and Navigation Guidance System used to locate potential fishing zones and incurred expenditure of Rs.3.57 crore upto March 2004. It had anticipated market for 7000 fish finders. It was able to sell only 199 at Rs.1.15 crore. Thus, it suffered a loss of Rs.1.78 crore in the project. Apart from this, Rs.64 lakh was lying in work-in-progress as at the end of March 2004.

The Management stated (April 2004) that the product was launched only after market survey and all efforts were being made to sell existing inventory. However, the fact remains that the Company could sell only 199 out of 400 manufactured against projected market demand for 7000 Nos.

(iv) Brushless Motors

The Company entered into an agreement (August 1998) with M/s. Carson Technologies Inc., USA (CTI) for manufacture and supply of its products (Brushless motors and spare

parts) on 100 per cent buyback basis. Against the order of CTI, the Company could supply certain spares and in the meantime CTI was taken over (July 1999) by another Company (M/s. Pittman, USA). M/s. Pittman refused to take the motors/spare parts manufactured by the Company on quality grounds. The project was shortclosed by the Company and the inventories of spare parts manufactured valuing Rs.1.86 core were written off in 2003-04.

The Management stated (January 2004) that the possibility of liquidating the inventories was being explored. The fact, however, remains that instead of liquidating the inventories in a fruitful way the Company wrote off these in the year 2003-04.

6.5.4 Sundry Debtors

The table below indicates the position of outstanding debtors for the last three years ending 2003-04:

(Rs. in crore)

Particulars	**Government Departments**			**Government Companies**		
Outstanding:	31.3.02	31.3.03	31.3.04	31.3.02	31.3.03	31.3.04
(i) Upto 1year	347.73	445.69	476.54	71.54	39.55	44.62
(ii) More than 1 year but less than 2 years	76.85	92.47	54.11	10.26	4.11	10.26
(iii) More than 2 years but less than 3 years	48.06	35.69	35.75	4.23	6.90	1.67
(iv) More than 3 years	99.19	116.98	112.88	18.85	18.17	23.65
TOTAL	**571.83**	**690.83**	**679.28**	**104.88**	**68.73**	**80.20**

Particulars	**Private Customers**			**Total**		
Outstanding:	31.3.02	31.3.03	31.3.04	31.3.02	31.3.03	31.3.04
(i) Upto1year	22.16	33.91	28.67	441.43	519.15	549.83
(ii) More than 1 year but less than 2 years	6.59	6.12	2.46	93.70	102.70	66.83
(iii) More than 2 years but less than 3 years	2.46	1.10	2.63	54.75	43.69	40.05
(iv) More than 3 years	5.09	6.41	8.55	123.13	141.56	145.08
TOTAL	**36.30**	**47.54**	**42.31**	**713.01**	**807.10**	**801.79**

Though at the end of 2003-04, 95 per cent of the total sundry debtors were outstanding from Government Departments and Government Companies, the position was alarming as most of the debts were unreconciled and unconfirmed.

Debtors outstanding as on 31 March 2004 included Rs.144.65 crore, representing 5 per cent/ 10 per cent balance payments due against supplies made but remaining unbilled which constituted 21.29 per cent of total debts due from Government Departments. Out of this an amount of Rs.35.85 crore remained unbilled for more than one year.

The Management stated that terms of payment regarding balance 5 per cent/10 per cent was linked to certification by the customers on receipt and acceptance of the goods at site. The reply is not tenable since according to the general terms and conditions of

supply of stores, certification of receipt of goods or discrepancies regarding supplies is to be made not later than 60 days of receipt of goods by the customers and in the absence of this the Company could prefer the bills and the customer has to make payment. The fact that the Company did not raise the bills beyond 60 days indicated that the discrepancies raised by customers were not set right, resulting in unbilled debtors.

6.5.5 Foreign Exchange Variation

The purchase orders placed by the customers of the Company allowed it to claim any exchange rate variation between the exchange rate considered for fixation of price and actual exchange rate incurred upto a cut-off date. A test check of the cases of imports by the Company revealed that it was not adhering to cut-off dates prescribed by the customers for importing materials required for execution of the orders in spite of receipt of initial advance/progressive advances and consequently, any exchange rate variation beyond the cut-off date had to be borne by the Company. Non-adherence to cut-off dates prescribed by the customers for importing material required for execution of the order and consequent variation in the exchange rate beyond cut-off date, which was not reimbursed by the customers amounted to Rs.5.64 crore (8 cases) between January 1998 and February 2002. Further, delay in preferring claims towards exchange rate variation with the customers resulted in loss of interest of Rs.7.95 crore.

The Management stated that where there were technical and commercial uncertainties and where material procurement involved concurrent engineering and had long gestation period, the procurement action went beyond the cut-off dates and was not on account of operational inefficiencies in procurement of materials.

The reply of the Management is not tenable as they could have taken up the matter with the customer, explaining the unavoidable circumstances causing delay in procurement and sought extension of cut-off dates and amendment to the purchase orders. Moreover, delay in preferring claims was solely attributable to the Company and calls for better Managerial and Financial control.

6.6 Internal Controls

Designing, installing and operating systems for proper control is being carried out by the respective departments. The review of systems, procedures, adequacy and effectiveness of internal control is assigned to the Internal Audit Department in the Company.

The Internal Audit Department is presently headed by Additional General Manager (IA) who reports directly to the Director (Finance).

As a measure of internal control, the Company has manualised its various business operations and has issued 13 manuals/procedures. A review of internal controls as existing in the Bangalore Complex of the Company revealed the following:

6.6.1 Manuals

The Company had computerised many areas of its business transactions and consequently a number of changes had taken place necessitating quantitative as well as qualitative changes in control measures, but the manuals and quantum of checks were not updated taking into account this aspect to make internal control system effective.

The Management stated (November 2003) that the manuals were constantly under review and, wherever felt necessary, action was being initiated to update the respective manuals.

The reply is not tenable as there was no revision in respect of nine manuals and in respect of other manuals/procedures the last revision was made only upto 1997.

6.6.2 Information Technology

The Company had not established IT security policies and procedures. Even the consultants M/s. TCS opined (June 2002) that IT securities implemented by the Company were in pockets and not adequate which constituted security risk. As most of the Management Information System (MIS) reports including financial and accounting information, emanated from computerised environment, any inadequacy in internal controls in place could adversely affect not only the quality of decision-making but also correctness and reliability of financial and accounting reports.

6.6.3 Cash Management

Employees have been authorised to issue bus passes, bus tickets, canteen coupons etc., by collecting the value in cash without any surety.

No limits had been prescribed for authorisation of payments by Officers above Accounts Officer level and this was a serious lacuna in the internal control system with regard to delegation of powers.

Regional offices were not maintaining cheque receipt register to record the date of receipt of cheques from the customers and depositing them in the Bank. In its absence, the delay in obtaining the cheques from the customers as well as in depositing in the bank could not be ascertained in Audit.

The Management stated (November 2003) that there was no delay in depositing the cheques in the banks. The fact, however, remains that there was no record to show that there was no delay.

6.6.4 Inventory Management

No norms have been fixed for losses / wastages of raw materials for manufacture of major products and materials in stores / transit. Though this lapse had been consistently commented upon by the Statutory Auditors, the Company had not taken any corrective action to avoid excess wastage/loss.

The Management stated (November 2003) that it was not possible to prescribe any norms for production losses / wastages. The reply is not tenable as in the absence of norms it is not possible to take effective measures to control such losses.

A test check of the procedure followed in the Bangalore Complex revealed that the rejected materials were not brought to books though there was a separate account code to incorporate such transactions. The Divisions were taking up the matter directly with the suppliers with the result that there was no control record to monitor the replacement of rejected material. Based on Audit observation (August 2002), detailed guidelines to be followed in respect of such rejections were issued only in March 2003.

The Management stated (November 2003) that guidelines were issued only to ensure the compliance by divisions/units. From the reply it is evident that prior to Audit observation, the existing procedures were not properly followed.

The Sub-Contract Procedure introduced in 1996 stipulated that sub-contract department should obtain a certificate every six months from each sub-contractor acknowledging the

extent of material lying with him. It was observed that this procedure was not followed scrupulously, resulting in continuance of huge un-confirmed balances with the sub-contractors. An amount of Rs.4.26 crore was shown as value of materials with sub-contractors as on 31 March 2004 which were not confirmed. Age-wise analysis of materials with sub-contractors was also not maintained.

The Management assured (November 2003) that efforts were being made to reconcile the amount of materials issued to sub-contractors and issued on loan.

6.6.5 Sales

Reconciliations are a critical control mechanism to ensure the accuracy and completeness of transactions. However, it was noticed that the balances with customers under sundry debtors and advances remained unreconciled and unconfirmed for many years and there was no improvement in this regard. On an independent verification done by Audit from five customers of the Company, it was found that there was a difference of Rs.171.53 crore as of March 2003 with the balances in the Company's books. The Company assured (August 2003) to take special measures to reconcile the balances with the customers. The process of reconciliation was in progress (June 2004). This nevertheless shows that internal controls were weak in this area.

There was inordinate delay in forwarding the invoices (even for 90 per cent/95 per cent claims) to the customers for realisation of sale proceeds. On a test check of 200 invoices in July 2003, it was seen that in respect of 105 cases, such delay ranged from 12 days to 424 days and loss in terms of cash credit interest attributable to such delay amounted to Rs.3.93 crore.

The Management stated (November 2003) that the procedural requirements such as obtaining provisional receipt from the consignee, specimen signatures of the consignee / attestation of overwriting by the consignee etc. were the causes of delay. The reply is not tenable as the cases test checked in Audit did not involve requirement of provisional receipt for claim of 90 per cent/95 per cent value of the supplies. Further, obtaining specimen signatures, avoiding overwriting etc., were administrative in nature and were controllable with proper follow-up system.

Thus, the Company's existing internal control procedures were not adequate to keep pace with increasing business activities and change in technology. This also adversely affected coverage by internal audit in quantitative as well as qualitative terms.

6.7 Conclusions

- (i) Due to preparation of unrealistic feasibility report, underutilisation of capacities, non-receipt of anticipated orders etc. the investment made in seven projects was idle/unproductive.
- (ii) Despite changes in production facilities the method of capacity determination adopted in 1987 was not reviewed.
- (iii) Inadequate monitoring of inventory holding resulted in accumulation of slow-moving/non-moving inventory.
- (iv) Decline in the sales to non-defence sector was a cause for concern in the context of Government advice (October 2000) to the Company to prepare itself for an era of free trade.

(v) The Company's existing internal control procedures were not adequate to keep pace with increasing business activities and change in technology.

6.8 *Recommendations*

(a) The projects should be reviewed during their currency with reference to the parameters fixed in the feasilility reports.

(b) The method of determination of capacities should be reviewed to assess them correctly.

(c) Inventories should be monitored closely to avoid accumulation and loss due to obsolescence.

(d) The Company should explore the non-defence sector more vigorously.

(e) Internal control mechanism should be strengthened.

The review was issued to the Ministry in December 2004; its reply was awaited (January 2005).

CHAPTER : VII

Bharat Electronics Limited

Information Technology Audit on the computerisation of inventory management at Bangalore Complex

Highlights

The primary objective of implementation of Integrated Information System with particular emphasis on scalability and upgradeability was not achieved.

(Para 7.4.1 and 7.4.2)

The Company has not formulated and followed proper change management procedure for modifications to the system.

(Para 7.4.3)

Procedures for integration, processing data and controls built in the system to validate the data processed were not available. Discrepancies to the tune of Rs.67.75 crore existed in the comparable data between Manufacturing Resource Planning System-II (MRP-II) and Integrated Finance Accounting System (IFAS); 350 Nos. of items valued at Rs.26.07 crore appearing in IFAS did not appear in MRP-II.

(Para 7.5.1)

Alteration of financial data in IFAS for reversal of sale of Rs.29.78 crore was done but no alterations took place with stock position.

(Para 7.5.2)

The system did not help in purchase decisions and allowed drawal of material for the work order in excess of quantity prescribed in the Bill of Material.

(Para 7.5.3)

The criterion adopted by the system for fast, slow and non moving inventories analysis was flawed and consequently material worth Rs.2.16 crore which had not moved for one to two years was identified as fast-moving in one of the divisions.

(Para 7.5.6)

Rights of access had been given to employees without analysis of minimum access requirement.

(Para 7.6.1)

There is no evidence to show that system audit envisaged in the Internal Audit Manual had been conducted.

(Para 7.6.3)

The Company did not have a proper institutionalised business continuity plan.

(Para 7 6.4)

7.1 Introduction

The Bharat Electronics Limited (BEL) was incorporated in April 1954 as a Company fully owned by the Government of India under the administrative control of the Ministry

of Defence. The Company designs, develops and manufactures electronic equipment like Radars, Communication Systems, Broadcasting and Telecommunication equipment. The major production unit at Bangalore Complex is further restructured into seven Strategic Business Units (SBU).

7.2 Computerisation in BEL, BG Complex

Though the computerisation activity commenced in 1975, the Company implemented Integrated Information System (IIS) in 1998-99. IIS mainly consists of Manufacturing Resource Planning System-II (MRP-II) supporting manufacturing functions including inventory management and Integrated Finance Accounting System (IFAS) supporting financial functions.

The Information System (IS) Department takes care of all developmental activities, troubleshooting, overall management of IS resources, expansion and IFAS data processing. Apart from this, Computer (EDP) Section at each SBU takes care of MRP-II application, data processing on this application, daily back up and access rights.

7.3 Scope of Audit and Methodology

Audit of General and Application Controls with specific emphasis on Inventory Management and related modules of MRP-II and IFAS was conducted in 2003-04 mainly to examine:

- (i) whether planning and execution of the IIS project was effective and efficient,
- (ii) whether Information Technology (IT) systems helped in efficient and effective Inventory Management and Control and
- (iii) whether data and integrity of data entry were reliable and adequate.

The methodology adopted for audit included collection of information through questionnaire, test check of the system by examining the data entry with reference to source documents, personal interviews with officers of the EDP Wing and analysis of data through Computer Assisted Auditing Techniques namely, SQL[♣] and IDEA[♦].

7.4 Implementation of Integrated Information System (IIS)

7.4.1 The Company implemented IIS at a total cost of Rs.13 crore with emphasis on scalability and upgradeability, to meet the business challenges faced and provide a competitive edge to the operations. The major areas covered were production planning, material control, shopfloor scheduling and real time control, design development and commercial and sales management.

7.4.2 M/s. Mascon Technical Services (P) Limited, Chennai (MTS) completed in October 1994 the software relating to MRP-II. M/s. Tata Consultancy Services (TCS) completed in March 1995 the software work relating to IFAS with time overrun of 18 months. These softwares were put to use progressively upto 1998-99, due to delay in procurement of hardware and inadequate project monitoring. During development of IIS, even though data porting[♣] was the primary responsibility of MTS it was jointly done by MTS and the Company. Further, the Company failed to achieve objectives viz. integrity

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[♣] ***Structured Query Language***

[♦] ***Interactive Data Extraction and Analysis***

[♣] ***transferring of data to new system***

of data and upgradeability due to deficiencies in the system. Manpower problem also contributed towards delay in implementing the IIS project. Core group members were changed frequently due to resignation / transfer of the personnel during the design, development and implementation stage of IIS project. There was no specific IT recruitment policy in the Company.

7.4.3 The Company carried out many modifications and added new features to these softwares (IFAS and MRP-II) since commissioning of the system. However, the Company neither maintained any documentation of modifications nor formulated change management procedures. In the absence of proper change management procedure, the objective of scalability and upgradeability of software was defeated and Audit could not verify/assess the accuracy of the data migrated and modifications made to the softwares from time to time. The Company neither documented the testing procedures nor maintained documents to prove the accuracy of the data migrated from legacy system to IIS. Further, neither testing strategy nor documents like test reports were furnished to audit.

The Company stated that (February/June 2004)

(i) the problems faced in porting of the data were incomplete data, duplicate data and data integrity problems.

(ii) the integrity of data was ensured within the applications and the Company added many features/modules on account of the system's amenability to extension and improvement and was able to upgrade the hardware by adding disc space and memory. It further stated that top management did review the project regularly by constituting a Committee of Directors to oversee the implementation. The objective of scalability and upgradeability had been taken care of in the systems and in the process of change-over to the new system, the change management control problems would be addressed.

(iii) it did not find any need to have separate formal IT recruitment policy. However, it added that it had asked M/s. TCS (whom the Company had appointed as consultant for the augmentation program of computerisation) to study and advise on the need for such policy.

The reply of the Company is not acceptable as

(i) The methodology adopted by the Company in resolving the issues of porting could not be analysed in Audit in the absence of documentation.

(ii) As could be seen from the Annexure-5, there was difference between IFAS and MRP-II data as on 31 March 2003. Poor documentation, change management practices followed and deficiency in Application controls in the system resulted in data available in the system being low on realiability and the system lacking upgradeability/scalability in the long run.

(iii) To overcome the shortcomings in the existing system, the Management appointed TCS to identify the gap within three years after implementation of IIS. Further, while clarifying to the Board's Sub-Committee, TCS stated (July 2003) that the current MRP systems were developed at various points of time and hence they could not talk to each other due to which consolidation of data had to be done manually, (i.e., manual intervention still existed). The application software only

met partial requirements of the transactions and did not support process control and decision-making. Therefore, the consultant recommended implementation of Enterprise Resource Planning (ERP) at an estimated cash outflow of Rs.56.92 crore over five years. The selection of the ERP package and vendor was in progress (August 2004).

7.5 Application Controls

Audit of Application Controls in the system with specific emphasis on Inventory Management revealed a number of demerits in the Inventory System. The Company's MRP-II application caters to online maintenance of stock data, follow up, control and generation of documents relating to inventory. IFAS receives input from MRP-II and generates financial, material and cost accounting statements. Points observed in Audit on analysis of inventory data under MRP-II/IFAS are commented upon in succeeding paragraphs:

7.5.1 Discrepancies in comparable stock data between MRP-II and IFAS

The data relating to Purchase Orders, Sub-Contract Orders, Service Orders, Store Receipt Control, Sale Orders and Invoice, transaction-wise, are transferred from MRP-II to IFAS in respect of the previous month as database dump to IFAS system in batch mode.

The checks and validation required for IFAS like total number of transactions being transmitted, date of transactions, validity of transactions, and key field entries to IFAS are being carried out at entry stage in MRP-II. However, the controls built in the system to validate the transferred data processed in IFAS are not available. It was also observed that the system generated the error-list of data transferred from MRP-II to IFAS at the time of monthly processing. It was clarified to Audit that the error-list generated during the process of data transfer from MRP-II to IFAS was being corrected. However, no documentation was maintained to check the accuracy of data corrected and number of errors detected over a period of time. In view of the above, discrepancies existed in the comparable data between the two systems identified by the Company, as detailed below:

Division	Total items in MRP-II	Total items in IFAS	Items in MRP but not in IFAS	Items in IFAS but not in MRP-II	No. of Cases where IFAS stock is less than MRP-II	No of Cases where MRP-II stock is less than IFAS	Unit discre-pancies
Digital Communication Systems	13028	12536	55	20	141	110	5
High Frequency	17697	15187	16	12	63	46	4
Low Power Equipment	38888	19655	134	40	262	112	5

In order to examine the discrepancies, Audit carried out a test-check of comparable data of inventory of raw material and finished goods available in MRP-II and IFAS as on 31

March 2003. The test check revealed that (i) raw material stock valued at Rs.64.47 crore and finished stock valued at Rs.3.28 crore figuring in MRP-II, did not find place in IFAS and (ii) 350 items of raw material valued at Rs.26.07 crore figuring in IFAS did not find place in MRP-II. Thus, the reliability of data was low and non-reconciliation of data between MRP-II and IFAS vitiated the accuracy of financial statements.

The Company stated (June 2004) that MRP-II assisted in planning, procurement, issue of material etc. on on-line basis. The data relating to quantity of inventory of MRP-II was transferred to IFAS and processed for preparation of material ledger, age-wise analysis etc. in batch mode. Hence they were on different modes and not comparable at value level. All the entries including adjustment values were recorded only in IFAS. However, the Management also stated that efforts were on to reconcile MRP-II and IFAS balances at quantity level on continuous basis. The Company agreed to address these issues in the new system (ERP), for avoiding such data discrepancies.

The absence of reconciliation and necessary adjustments in MRP-II posed a serious risk to the planning and procurement decisions based on the unadjusted MRP-II data.

7.5.2 Non-adjustment of finished Goods (FG) stock in the event of reversal of sale

The Company was effecting sales by entering the transaction in the system with documents such as Invoices, Goods Consignment Notes, Material Gate Pass etc. These were simultaneous actions based on which the sale action was completed and the property passed on to the customer. When the sale was effected, the system generated Stores Issue Voucher (SIV or Invoice) which formed the basis for decreasing the quantity in FG stock by the system.

Audit observed (April 2004) that during 2002-03, in respect of 306 items valued at Rs.29.78 crore, the system had entries of SIV, Goods Carrier (GC) Note, and accordingly the system recognised the sale and the FG stock in the system was reduced. However, the Company reversed the sales in June 2003 by altering the invoice date and value in the IFAS; the quantity of those items in IFAS and MRP-II remained unaltered. Thus, the system was allowing alteration of the date of invoice and value without correspondingly updating the stock position.

The Management stated (June 2004) that because of the announcement of Truckers' strike, the consignment was not lifted by the transporters before 31 March 2003; hence reversal entry was made in the books. It also stated that same SIVs were used to account for the subsequent sale because it would facilitate clearance with excise/sales tax authorities. It added that necessary improvements, if any, would be considered while introducing the new system.

The Management, thus, accepted that before 31 March 2003 the consignment in question was not despatched which showed that the validation checks exercised for sales transaction like entering correct GC Note, etc. were not adequate.

7.5.3 Drawal of material in excess of Bill of Material (BOM) quantities

The BOM Module is used for drawing material for production of an item. On a test-check, it was found that the application allowed drawal of material for the work order in excess of quantity prescribed in the BOM as illustrated below:

Part No.	Work order No.	Required Qty. as per BOM	Actual Qty. issued to work order	Excess quantity
2124 322 201 36	960146	24	28	4
2124 480 201 75	960146	24	28	4
2124 364 901 73	960151	13	36	23

The Management stated (June 2004) that as the lead time required to manufacture these items was two to three months, a few extra were launched to cope with shop floor rejections. The reply is not acceptable as drawal of material in excess of quantity indicated in BOM amounts to lack of proper validation checks. Further, in case of necessity of excess quantity on account of genuine reasons, the procedure as laid down in the Purchase Manual (i.e., drawal through Pink Stores Requisition) was required to be followed to regulate the transaction through the system.

7.5.4 Non-netting of quantities while processing Purchase Requisition (PR)

In the process of generation of PR, the system was not able to identify whether the items included in the PR were available with other SBU or not. Hence the SBU had to resort to oral confirmation. Thus, the system did not help in purchase decisions.

The Management stated (June 2004) that the common items were held in Common Material Control (CMC) division and items held in a division were unique to its requirement. The reply is not acceptable as there were many internal transfers of items other than CMC-held items between divisions. However, in its reply, the Company conceded that netting across the SBUs would be taken care of in the proposed new system.

7.5.5 Non-closure of work orders after completion

It was observed that majority of work orders were not closed in the system even though work was completed. It may be noticed from the table below, based on a report generated by Audit from the system, that the work orders opened during a year were always more than the work orders closed during the year.

Year	1999-00		2000-01		2001-02		2002-03	
SBU	No. of Work orders opened	No. of Work orders closed	No. of Work orders opened	No. of Work orders closed	No. of Work orders opened	No. of Work orders closed	No .of Work orders opened	No. of Work orders closed
Naval	420	152	143	21	196	15	42	0
Low Power Equipment	352	11	174	7	108	1	69	0
Broadcast and Television	228	0	111	0	124	1	152	6
Radar	656	97	99	23	66	5	107	0

Components	54	0	698	0	1627	2	1376	0
High Frequency	243	0	119	0	37	1	60	0

On this being pointed out in Audit, the Management took action to close 103 work orders in August 2003 and initiated action to review the position of closing of work orders. However, the Company did not elaborate (June 2004) on how it planned to consider automation of closure of work orders immediately after work order activity was closed so as to eliminate scope for drawal/adjustment of material through closed work orders.

7.5.6 Wrong programme logic in analysis of Fast, Slow and Non-Moving (FSN) Inventory

An analysis of inventory held on 31 March is carried out every year to identify slow-moving and non-moving items. The objective of FSN analysis is to identify items which have not moved for many years and analyse the same for their utility. Based on the FSN reports, review of items which have not moved for more than five years is carried out by internal committees to recommend write-off and disposal. For the purpose of analysis, the system classifies items not moved for more than two years as non-moving inventory and items whose movement is less than 10 per cent of the opening balance of a particular year as slow-moving inventory. The inter-departmental transfer of items is not considered as consumption for the year. The remaining items are classified as fast moving inventory.

On a check of data relating to FSN, following flaw in the programme logic was noticed.

(i) Items valued at Rs.2.16 crore, which have not moved for more than one year but less than two years, were classified as fast-moving inventory.

(ii) Out of the inventory of Rs.2.13 crore pertaining to Central (D&E) Division, inventory valued at Rs.2.11 crore was classified as fast-moving and Rs.2 lakh was classified as slow-moving. On verification, it was found that almost all the inventory held by the Division had been transferred from Common D&E Division during July 2001 and was more than five years old.

The Company stated (October 2003) that the system would be reviewed to classify the items, which had not moved between one and two years also as slow moving inventory. It was also stated that the transfer of materials from one store to another during July 2001 was inadvertently accepted as fresh receipt and the mistake had since being rectified.

7.6 Deficiencies in General Controls

7.6.1 As per instructions (July 2001) regarding access controls, the computer centre should compile the list of Forms (for insert/update/delete/report access right) for each employee in consultation with Departmental Heads and obtain written approval. However, it was observed that:

(i) In HF Division - Computer Centre, no written approvals for providing access to the staff were available.

(ii) In Central Material Management Department, general authorisation was given to 68 employees without making proper analysis of minimum access requirement to discharge their duties.

(iii) Report and Query rights (read only) associated with the module were provided generally to all the employees, working in the respective module, without making analysis of need to know/need to work.

(iv) Based on the Audit observations, the Company issued instructions to all Departmental Heads to review and confirm permission already given to each user and to advise the Computer Centre in writing about changes, if any.

7.6.2 The Company has not acted upon the important suggestion made in the Security Manual relating to IT system to have a separate security server administering all terminals. TCS also had opined that IT securities implemented by the Company were in pockets and were not adequate, constituting security risk.

The Management stated (June 2004) that the security needs as relevant in 1990 were addressed. They agreed to formulate a security policy and procedure.

Further, the Ministry of Defence (MOD) in June 2001, had issued certain computer security guidelines and had instructed all Defence PSUs to follow them. Following guidelines were not complied with by the Company.

(i) The Company had not assessed the exact requirement of software licences and had not procured the required software wherever necessary.

(ii) Passwords were changed monthly instead of fortnightly and special characters were not enforced.

(iii) Audit trails and Audit Logs, though enabled, were not periodically reviewed.

On this being pointed out by Audit, the Management took necessary action to comply with the above guidelines.

7.6.3 The Internal Audit Manual stipulates that Information and System (IS) Audit is to be carried out by Internal Audit Department covering check of operating logs, control over backup data, input and processing controls, data security etc. A review of Internal Audit Reports did not evidence any such IS Audit conducted in line with manual instructions.

The Management stated (June 2004) that Audit was conducted covering various reports generated through computers on the related areas, viz., payrolls, purchases, stores, sales, assets verification etc., and exception reports were audited. The reply is not acceptable as data extraction is only a part of IS Audit. The main purpose of IS Audit is to assess the adequacy of controls in IT environment to ensure data accuracy, reliability and confidentiality.

7.6.4 It was observed that though the Company took backup of data on daily, weekly and monthly basis, in the of absence of version control number for backups, it was not able to furnish the Inventory data of earlier years as per financial statements. Hence, Audit was not able to assess the accuracy of data available in the system. Based on the Audit observation, the Company took action to take system level backup and also agreed to formulate, prepare and implement suitable institutionalised business continuity plan.

7.7 *Conclusions*

(i) The primary objective of implementation of IIS with particular emphasis on scalability and upgradeability was not achieved as the planning and execution of the IIS project was not effective.

(ii) The software that had been developed was primarily a transactional system with little support for online analysis or decision-making.

(iii) System documentation was lacking and consequently the upgradeability was low.

(iv) General and Application Controls operated in the IT environment in Bangalore Complex were not effective.

(v) There was high volume of manual intervention of data adjustments resulting in human errors.

(vi) Non-reconciliation and existence of discrepancies in data between MRP-II and IFAS existed which did not help in decision-making.

7.8 *Recommendations*

The Company should consider the introduction of ERP system which will take care of deficiencies mentioned above. The control environment needs to be made stronger including access and processing controls to ensure data integrity and security. The Company needs to formulate a proper institutionalised business continuity plan.

The review was issued to the Ministry in November 2004; its reply was awaited (March 2005).

CHAPTER : VIII

Garden Reach Shipbuilders & Engineers Limited (GRSE)

Shipbuilding activities

Highlights

The actual utilization of the shipyard as a whole was not determinable, as the company did not assess the capacity of the yard in terms of a single parameter like 'Standard Ship units', as prevalent in the shipbuilding industry. Also the target fixed for its hull construction shops was not realistic.

(Para 8.4.1)

The Company has always fixed the targets lower than the assessed capacity. The installed/assessed capacity fixed in the year 1982 measured as Hull construction capacity in terms of tonnage of steel fabricated has not been reviewed since then.

(Para 8.4.2)

The capacity of shipbuilding facilities namely Building Dock, Building Berth, Slip Ways, Wet Basin and Fitting out Jetty has been assessed in terms of period of occupation of these facilities.

(Para 8.4.3)

Though the Company consistently earned profits during the period of report, the same may, however, be viewed in the light of the advantage of cost plus nature of the contracts. Further, actual profits always remained lower than the planned profits.

(Para 8.4.4)

There was delay ranging from one month to 125 months in delivery of vessels during last six years resulting in imposition of penalty by customer amounting to Rs.7.35 crore.

(Para 8.4.5)

There was a cost overrun of Rs. 1669.88 crore in the construction of 15 vessels constructed/delivered from January 1997 to March 2002.

(Para 8.4.5)

Due to ill planning and poor productivity of manpower, Company incurred an unproductive expenditure of Rs.14.28 crore on idle labour whereas on the other hand it incurred Rs. 52.27 crore on overtime during the period of report.

(Para 8.5.1)

The company did not maintain appropriate records for vessel wise consumption of vital input material like steel.

(Para 8.6)

8.1 Introduction

Garden Reach Shipbuilders & Engineers Limited (GRSE/Company) is a wholly owned Government Enterprise under the administrative control of the Department of Defence Production and Supplies in the Ministry of Defence. The Government of India acquired

the erstwhile Joint Stock Company under the name and style of Garden Reach Workshop Limited in April 1960 to cater to the defence requirements for shipbuilding and ship repair. Presently, the Company carries out shipbuilding and ship repair through its Ship Division, construction of bailey bridge, deck machinery items, deep well turbine and submersible pump through Engineering Division and construction of Diesel/Gas engine through Engine Division. Of these, shipbuilding is the main activity in terms of revenue earnings, resource allocation etc.

8.2. Objectives and scope of audit

The present review covers the performance of shipbuilding activities for the period from 1998-99 to 2003-04. The objective of audit was to assess the economy, efficiency and effectiveness of the shipbuilding activities undertaken by the Company, which contribute on an average about 85 percent of its total turnover. For this purpose the records of Ship division were reviewed during the period from December 2003 to April 2004. The records pertaining to Planning, Design and Estimation could not be verified as these were claimed by the Management to have been destroyed in a fire, which occurred on 5 November 2002.

8.3. Organisational set up

The Ship Division is headed by Director (Shipbuilding), who reports to the Chairman & Managing Director (CMD). He is assisted by two Chief General Managers, one each for Main Works (MW) and Fitting Out Jetty (FOJ), two General Managers, one for Materials and the other for Design and three Deputy General Managers, one each for Finance, Industrial Engineering & Production (IE&P) and Production Planning & Control (PP&C).

8.4 Production Performance

On production, capacity fixation and the performance of the Company, the points observed are detailed in succeeding paragraphs.

8.4.1. Non fixation of Ship Production Capacity

Shipbuilding is essentially a manufacturing-cum-assembly industry encompassing activities such as main steel fabrication, manufacturing of steel parts, assembly of sub-units and main units and sequential erection of the units to form a complete steel structure, out-fitting activities after launching, testing and trial of equipment and systems, Basin Trials, Sea Trials and Commissioning of the Ship. As such the capacity of the yard should be judged after accounting for all the stages of activity for various types/sizes of ships, which differ vastly in terms of quantum of work, construction complexities and sophistication. This required convergence of all aspects of ship construction into a single parameter for measuring production in physical terms like "Standard Ship Units" (SSU) as is prevalent in the ship construction industry.

It was observed that the Company had not measured its production in terms of standard ship unit (SSU) in line with other shipyards like Mazagaon Dock Limited and Goa Shipyard Limited working under the Ministry of Defence. In the absence of any such yardstick capacity utilisation of the yard as a whole was not determinable in terms of number/types and sizes of ships.

The Management stated (July 2004) that assessment of capacity in terms of SSU was attempted but considering the conditions that prevailed in the Company and the nature of

products, it was considered not applicable. The reply of the Management is not tenable, as other shipyards of the same Ministry had assessed their capacity in terms of SSU.

8.4.2 Capacity Utilisation of Hull Shop

The installed/assessed capacity of the Ship Division fixed in the year 1982 was expressed by the Management in terms of Hull Construction Capacity, which is equal to tonnage of steel fabricated. The Company has not reviewed its assessed capacity since then. The table below indicates the annual capacity with target of the Hull Shop for steel processing and actual tonnage of steel fabricated for the years 1998-99 to 2003-04:

Year	Assessed Capacity (MT)	Production Target		Actual Production (MT)	Percentage of actual production to	
		In MT	As percentage of Assessed Capacity		Production Target	Assessed Capacity
1998-99	5400	3200	59.26	3473	108.53	64.31
1999-2k	5400	1750	32.41	3181	181.77	58.91
2000-01	5400	702	13.00	1874	266.95	34.70
2001-02	5400	1080	20.00	1571	145.46	29.09
2002-03	5400	1620	30.00	2066	127.53	38.26
2003-04	5400	2750	50.92	3043	110.65	56.35

It may be seen from the above that the Company had always fixed the target substantially lower than the assessed capacity, the reasons for which were not on record.

The Management stated (July 2004) that the production target was fixed on the basis of available orders. The reply may, however, be viewed in the light of actual production which remained in the range of 108.53 to 266.95 per cent of the targets. In this context the Management contended that the structural jobs of Bailey Bridge and Material Handling Project were included which helped in surpassing the production targets. This contention is also not tenable, as the Company started doing fabrication job for other works in shipbuilding from the year 2001-02 only. Further, it covered only 16.67 per cent and 14.69 percent of targets during the years 2001-02 and 2002-03 respectively, as against the increase of actual production by 45.46 per cent and 27.53 per cent over the targets during the above years. As such there was no significant impact of undertaking fabrication of other works on the production targets.

8.4.3 Capacity Utilisation of Other Facilities

In addition to the hull construction facilities the Company, for the construction of its vessels, also has five other facilities namely (i) one Building Dock, (ii) one Building Berth, (iii) two Slip Ways, (iv) one Wet Basin and (v) Fitting Out Jetty. The capacity utilisation in terms of period of occupation of these facilities for the last six years ending March 2004 is indicated in the following table.

Facility	Percentage of Capacity Utilisation						
	1998-99	1999-2000	2000-01	2001-02	2002-03	2003-04	Average
Building Dock (primarily used for ship repairing)	50	58	92	83	100	33	69.3

Building Berth (used for pre-launching activities)	92	100	67	Nil	33	100	65.3
Slipway (used for pre-launching activities)	92	92	50	61	14	31	56.7
Wet Basin (mainly used for post-launch fitting-out jobs of small ships like FAC)	25	81	100	36	Nil	Nil	40.3
Fitting Out Jetty	100	100	100	100	100	100	100

From the above, it is evident that there was low and decreasing average utilisation of the available facilities relating to Building Dock/Berth, Wet Basin and Slipways.

It was further observed that the annual capacity of the above facilities in terms of particular mix of vessels or type of vessels had not been assessed separately. The Company has ascertained the utilisation of facilities in terms of their period of occupancy, which, however, did not indicate the norms for which these facilities should have been utilized for the particular job.

The Management while accepting the facts (July 2004) explained that most of the ships under construction were in fitting-out stage and consequently, Building Dock/Berth /Slipways could not be sufficiently utilised for pre-launching activities.

8.4.4 Production vis-à-vis Profitability

The entire production of the Company was meant for ships for the Indian Navy and Coastguard. Naval Shipbuilding in India is normally undertaken in the Defence Public Sector shipyards through two types of contracts known as "Cost Plus" and "Fixed Price" contracts. In the case of the former, the shipyard is required to be paid for all cost incurred (direct cost plus overheads) as well as fixed percentage of these costs as profit. In the case of Fixed Price contracts the shipyard agrees to build the vessel at a fixed price subject to escalation on different components of cost.

The value of actual production, planned production vis a vis profit with reference to the actual and planned production of the Ship Division for the last six years ending March 2004 was as follows:

(Rs. in crore)

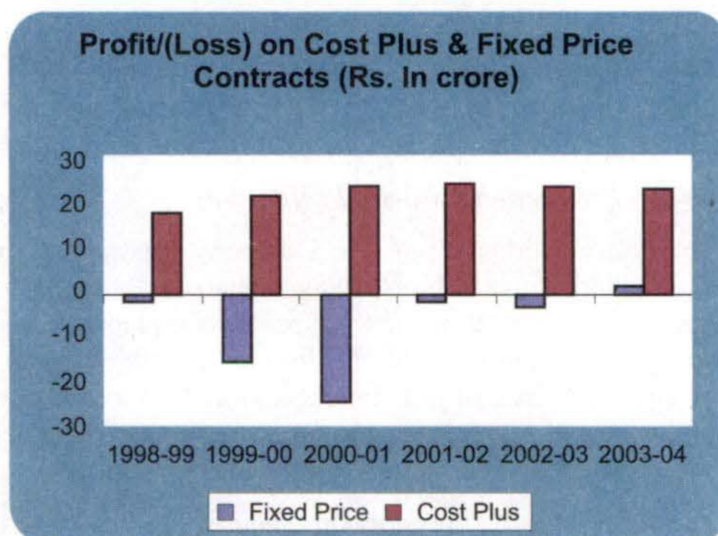
Year	Value of Production (VOP)		Profit	Percentage of profit on VOP
1998-99	Planned	285.82	23.68	8.28
	Actual	303.49	16.53	5.45
1999-2000	Planned	340.96	33.68	9.88
	Actual	359.34	7.34	2.04
2000-01	Planned	433.32	33.74	7.79
	Actual	442.41	0.07	0.02

2001-02	Planned	327.30	25.55	7.81
	Actual	420.25	24.03	5.72
2002-03	Planned	440.39	29.16	6.62
	Actual	433.01	22.17	5.12
2003-04	Planned	390.36	28.77	7.37
	Actual	415.19	24.92	6.00

Although the Company consistently earned profits, it may be seen that the actual profit always remained lower than the planned profits during the period of report.

It was further observed that during the period of review, of the 15 vessels delivered, 11 were on 'fixed price' and four on 'cost plus' contract basis. The profit/loss on each vessel and dates of laying keels, launching and delivery are detailed in Annexure-6. It would be seen therefrom that the 'cost plus' contracts, though small in number, formed the bulk of the Company's production and turnover on account of their high value while the fixed price contracts were of smaller value.

Graph-1



The profitability of fixed price vis-à-vis cost plus contracts for the last six years ending 2003-04 is depicted in graph-1.

It may be seen from the graph that in all the years the Company earned profit in cost plus contracts while it suffered loss in fixed price contracts except during 2003-04. This is due to the fact that 'cost-plus' by definition assures a profit while efficient and cost effective working is required for fixed price contracts, which was not witnessed in the Company. Thus, the profit of the Company may be viewed in the light of advantage of cost plus contracts.

8.4.5. Time/Cost Overrun and Liquidated Damages

Of the vessels delivered by the Company in the last six years, nine were built for Indian Navy and six for the Coast Guard. The Company could not deliver a single vessel within the scheduled delivery date. The delay in delivery of vessels ranged from one to 125 months as would be evident from Annexure-6. These delays were attributable to (i) non-availability of vital imported and major equipment in time, (ii) delay in approval of drawings, (iii) delay in finalisation of contracts and (iv) delay caused by sub-contractors. The inability of the Company to deliver ships on time led to customers claiming Liquidated Damages (LD) amounting to Rs.14.91 crore during the years 1998-99 to 2002-03. Of this, Rs.7.56 crore was later refunded/recommended for refund and the

balance amount of Rs.7.35 crore was a loss to the Company. A few instances detailing time and cost overrun and deduction of LD are given in the table below:

Sl. No.	Name of the vessel	Scheduled date of completion/ initial awarded cost	Actual date of completion/ actual cost	Time Overrun	Cost Overrun (Rs. in crore)	Liquidated damage (Rs. in crore)
1	Landing Ship Tank Large	December 1991/ Rs. 46.48 crore	January 1997/ Rs. 127.42 crore	5 years	80.94	4.85
2	Fast Attack Crafts (four)	November 1997 to May 1999/ Rs. 153.60 crore	September 2000 to January 2002/ Rs. 161.19 crore	32 to 34 months	7.59	0.42
3	Hovercraft (six)	August 2000 to February 2002/ Rs. 49.17 crore	August 2000 to March 2002/ Rs. 50.90 crore	One to six months	1.73	0.32
4	Fleet Tanker	December 1991/ Rs.68.47 crore	March 2000/ Rs.271.30 crore	Eight years	202.83	
5	Frigates (three)	December 1995 to December 1999/ Rs. 360 crore	one Frigate- March 2000 Two Frigates not yet delivered/ Rs. 1736.79 crore	Four years in one frigate to be delivered in December 1995	1376.79	

In addition to the liquidated damages imposed in the case of vessels mentioned at Sl. No.1-3 above, the Company also suffered a loss of (i) Rs. 6.22 crore due to acceptance of Rs. 121.20 crore only by the Navy against the cost of Rs. 127.42 crore in case of Sl No. 1, (ii) Rs. 3.85 crore due to failure of two gear boxes purchased from Kirloskar Penumatic Company Limited which was neither re-imbursed by the party nor by the Navy in the case of Sl No. 2, (iii) Rs. 1.59 crore due to higher sea freight not envisaged in the original estimates in the case of Sl No. 3 and (iv) Rs. 26.30 crore as the Navy converted the contract in the case of vessel at Sl. No.4 from 'cost plus' to 'fixed price' contract at Rs.245 crore due to which the Company also lost profit margin at the rate of 7.5 percent amounting to Rs. 20.35 crore.

The Management stated (July 2004) that:

(i) in case of vessel at Sl. No.1, monthly progress report was given to Naval Headquarters (NHQ).

(ii) in the case of Sl. No.2, the reimbursement of extra expenditure on account of failure of two Gear Boxes was under active consideration of Naval Headquarters.

(iii) in the case of vessels indicated at Sl. No.3, the delay was due to unforeseen modifications necessary on the British design to suit Indian conditions.

(iv) in the case of vessels at Sl. No.4, non-payment of labour overhead was in excess of contract value of Rs. 245 crore.

(v) in the case of vessel at Sl. No.5, the cost overrun was due to involvement of more labour on account of modifications/changes for the vessels.

The reply of the Management is not tenable in view of the fact that:

(i) in case of vessel at Sl. No.1, Navy had observed in October 1994 that no plan existed with the yard for weekly production monitoring resulting in continued accumulation of work.

(ii) in the case of vessels at Sl. No.2, the Navy expressed its inability in August 2003 to reimburse the extra expenditure of Rs. 3.85 crore due to non existence of any provision in the contract.

(iii) in the case of vessels at Sl. No.3, these were the inherent problems for which the Company should have take preemptive measures to deliver the crafts within the scheduled time.

(iv) in the case of vessel at Sl. No. 4, the final contract price was fixed which included 110 lakh man-hours (LMH) as against the original estimate of 70 LMH. Against this the Company actually consumed 117.46 LMH; and

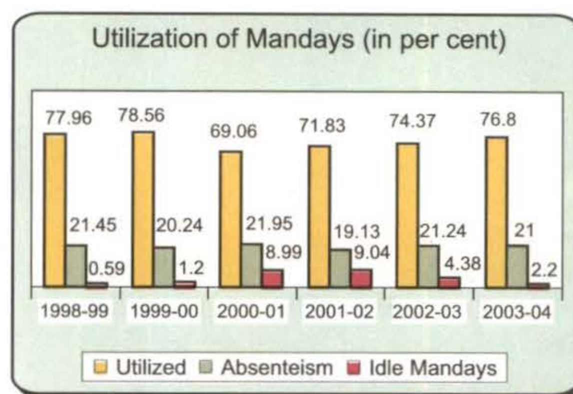
(v) additional labour was used in transportation alignment, erection and fabrication of smaller block units with regard to vessels at Sl. No.5 rather than in modification/changes in design as contended by the Management.

8.5. Manpower Utilisation

Shipbuilding activity, being a labour intensive industry, calls for effective and efficient utilisation of available manpower. The following table indicates the total available vis-a-vis idle man-days and the cost of idle man-days during the six years upto 2003-04.

Particulars	1998-99	1999-00	2000-01	2001-02	2002-03	2003-04
Number of workers	4438	4369	4182	3946	3674	3311
Total Man days available	1300334	1280117	1225326	1156178	1076482	970123
Actual Man Days utilized	1013839	1005747	846230	830442	800614	745076
(a) for Production Jobs	773412	820774	687394	648231	607042	648052
(b) for Non-Production Jobs	240427	184973	158836	182211	193572	97024
Un-utilized man days						
Absenteeism	278862	259060	268944	221173	228688	203726
Idle Man days	7633	15310	110152	104563	47180	21321
Cost of Idle man-days (Rs. in crore)	0.28	0.62	4.74	4.99	2.38	1.27

Graph-2



The unutilized man-days during the period under review varied between 2.25 and 2.86 lakh man-days i.e. between 22 per cent and 23 per cent of available man-days during the period of report. It would be seen that the unutilized man-days were due to heavy absenteeism and idle manpower. Absenteeism during the period remained above 20 per cent of the available man-days indicating the Management's failure to effect internal control. Moreover, the idle man-days also showed a substantial increase during the years 2000-01 and 2001-02. It increased from 0.59 per cent in the year 1998-99 to 9.04 per cent in the year 2001-02 as is evident in Graph-2. The wasteful expenditure on idle manpower during the last six years was Rs. 14.28 crore.

The following table depicts the reason-wise categorization of idle man-days for the last six years ending 2003-04:

Reasons	Man days lost due to idleness						
	1998-99	1999-00	2000-01	2001-02	2002-03	2003-04	Total [Percentage to total idle man days]
Lack of work	2446	5862	91262	98888	37671	13007	249136[81.38]
Lack of Material	388	537	2349	2388	1825	1659	9146 [2.99]
Breakdown	107	311	1065	713	318	639	3153 [1.02]
Power failure	709	227	1042	3	460	403	2844 [0.93]
Other misc. reasons	3983	8373	14434	2571	6906	5613	41880 [13.68]
Total	7633	15310	110152	104563	47180	21321	306159 [100]

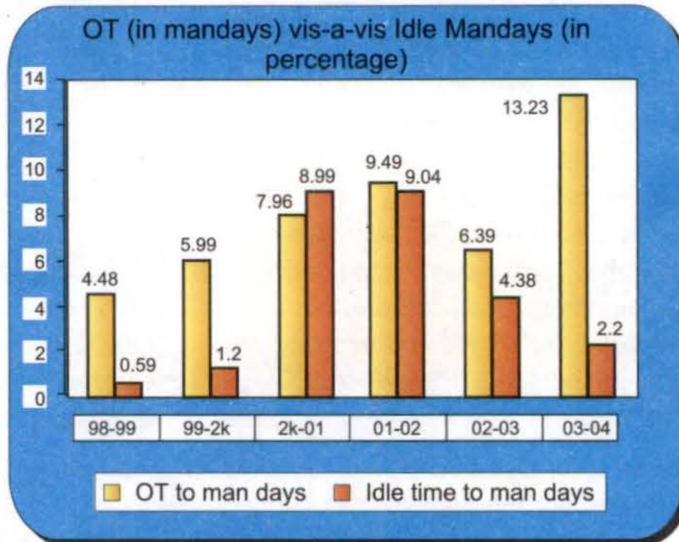
It may be seen that 81.38 per cent of idle man-days were due to lack of work and remaining 18.62 per cent were due to reasons such as want of material, machine/power breakdown and other miscellaneous reasons during the entire period of report. The Management did not plan the work schedule in such a manner as to engage all shops in work with proper integration among different shops to utilize the workforce effectively. Further, proper material procurement plans would have helped the Management to avoid the idle man-days due to lack of material (2.99 per cent). Idle man days on account of miscellaneous reasons were 13.68 per cent.

While contending that orders were not given due to delayed deliveries, the Management stated (July 2004) that the Indian Navy placed orders based on their acquisition budget and the shipbuilders' capabilities. This indicated that the Company failed to synchronize its various activities in order to utilize its workforce more effectively and efficiently.

8.5.1 Overtime vis-à-vis Idle Man-days

Graph-3

The Company incurred a total expenditure of Rs. 52.27 crore on overtime to its employees during the last six years ending 31 March 2004. Year-wise analysis of the overtime expenditure showed an increasing trend from Rs.4.29 crore (1998-99) to Rs.15.34 crore (2003-04). The percentage of overtime in man-days to total available man-days also showed an increasing trend from 4.48 per cent to 13.23 per cent during 1998-99 to 2003-04. Thus, while the Management failed to utilise the available man-days resulting in idleness on the one hand, it continued to allow considerable overtime on the other, as is evident from Graph 3. The Company could have at least reduced its overtime expenditure by Rs. 14.28 crore (the cost of idle man days) had it utilised its man-days effectively and efficiently. Despite huge expenditure on overtime, the Company could not deliver even a single vessel within the scheduled delivery period.

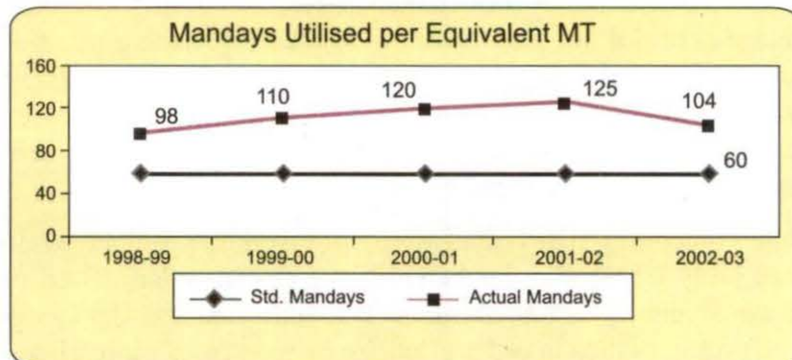


The Management stated (July 2004) that there was no workload in the Main Unit and hence idle manpower had to be redeployed at Fitting Out Jetty for gainful utilisation. The Management's efforts, however, did not reduce expenditure on account of overtime. Moreover, evidence regarding efforts for gainful utilisation of idle manpower was not found on record.

8.5.2 Failure to comply with Standards

Graph-4

The Company in agreement with Unions (January 2000), had been measuring the efficiency level by taking 60 man-days per equivalent tonne of steel fabrication. In the absence of any scientifically evolved norm, this can be taken as standard.



However, from Graph 4 it may be seen that actual man days spent per equivalent tonne of steel fabrication varied from 98 man days in the year 1998-99 to 125 man days in the year 2001-02 against the standard of 60 man days. This factor alone contributed an

element of additional expenditure of Rs. 25.68 crore during the period from 1998-99 to 2002-03 on account of wage/overtime bills of the employees.

The Management stated (July 2004) that there were disincentive provisions to enforce the achievement of targets. This was, however, not supported by any recovery on this account.

8.6 *Steel Consumption Analysis*

The Company did not maintain vessel wise actual quantity of steel consumed vis-à-vis estimated quantity and scrap generated indicating absence of control over the consumption of vital inputs like steel. Records produced by the Management could not be co-related to assess the effectiveness of internal control over consumption of steel.

The Management's claim (July 2004) that yard-wise steel consumption could be generated is not tenable, as it could not furnish the data regarding the estimated vis-à-vis actual steel consumption as asked for.

8.7 *Conclusions/Recommendations*

During the period under review none of the vessels was delivered within the stipulated time schedule. Despite poor capacity utilization, low productivity of labour, slippage in scheduled and cardinal dates, and consequent cost overrun, the Company was earning profit in all the years under review mainly because of 'cost plus' nature of contracts. The profit thus earned, did not reflect the actual performance of the Company.

The Company should work out and fix the Standard Ship Unit as is prevalent in the ship construction industry. In addition, the assessed capacity in terms of tonnage of steel fabricated in the Hull Shop was fixed as far back as in the year 1982 based on the then available facilities. This should now be addressed in terms of number of ships/vessels of various shapes and sizes that could be constructed annually with the existing facilities. In view of the time and cost overrun observed in shipbuilding activities of the Company, there is need for it to address its project implementation abilities. Further, the Company should implement normative costing system in its shipbuilding activities.

CHAPTER : IX

Hindustan Aeronautics Limited

Information Technology Audit on computerisation of integrated material management system

Highlights

The Company completed, *inter alia*, the networking in material management in March 2003 at a cost of Rs.13.29 crore. Due to non-compatibility between the Central and the Local Area Network (LAN)/Wide Area Network (WAN) Server Systems, only 322 computers had been connected to LAN/WAN (March 2004) as against 832 envisaged. Consequently, the LAN/WAN network established in these Divisions at a cost of Rs.2.53 crore is not being utilised optimally.

(Para 9.5.2)

There was no standardisation or documentation in the development of the software and the systems were not integrated with other functional areas.

(Para 9.5.3)

Procurement of IT assets was not centralised and the Divisional IT departments in Helicopter Division (HCD), Aero Engine Division (AED) and Overhaul Division (OHD) did not have control over the IT assets worth Rs.3.07 crore procured/positioned in the different Functional Departments as the details of configuration/location were not being maintained by them.

(Para 9.5.4)

The Company had not formulated any IT Policy.

(Para 9.6.1)

The absence of a well laid down password policy and logical access control mechanism rendered the system vulnerable for abuse besides making it difficult to fix responsibility in case of manipulation/corruption of the database.

(Para 9.7.2)

Various instances of deficiencies in application control resulting in incomplete, inaccurate and unreliable data were observed for want of required level of input controls, absence of validation checks/constraints at data entry level, duplication of work without compensating controls, duplicate material codes, duplicate part numbers, error in programme logic, non-inclusion of key fields, numerous manual interventions and non-devising of monitoring system.

(Para 9.8)

HCD charged of the sum of Rs.22.64 crore to consumption and cost of sales on an adhoc basis through a dummy work order.

(Para 9.8.1)

There were negative balances in the material ledger due to deficiencies in system logic/applications. Resultant adjustments that had to be carried out aggregated to Rs.51.38 crore during the year 2002-03 and Rs.67.47 crore during 2003-04.

(Para 9.10.1)

System deficiency resulted in creating 100 per cent redundancy provision even on those materials which were not falling within five year criteria.

(Para 9.10.2)

System deficiency led to erroneous computation of Weighted Average Rates due to non-linking of the repair charges to the original value. Erroneous consideration of the weighted average rate also vitiated the value of inventory.

(Para 9.10.3)

9.1 Introduction

Hindustan Aeronautics Limited (HAL) has 14 Production Divisions, seven at Bangalore and one each at Nasik, Kanpur, Koraput, Korwa, Hyderabad, Barrackpore and Lucknow.

9.2 Computerisation in the Company

The Company established LAN*/WAN♠ as a part of IT plan only in March 2003 though computerisation activity was commenced in the 1960s. The Application Software was developed in-house for Material Management, Manufacturing, Marketing and Customer Support, Human Resource Development and Finance functions.

9.3 Organisation

A Chief Information Officer (CIO) in the rank of Additional General Manager, who reports to the Director in charge of IT, was positioned (October 2001) at the Corporate Office in order to focus on IT Management. Chief Managers/Deputy General Managers head divisional IT Groups and they generally report to the head of the division.

9.4 Audit Objectives

The broad objectives of audit were to:

- (i) Undertake a general review of the implementation of the Corporate Information Technology (IT) Plan and the General Controls prevalent in the IT environment for Material Management;
- (ii) Obtain reasonable assurance that Integrated Material Management (IMM) System for accounting, data entry, processing and outputs was reliable; and
- (iii) Verify whether inventory data processed through application systems were reliable.

9.4.1 Audit Scope and Methodology

A review of efficacy of the IT systems and controls was undertaken in Audit in three selected Divisions of the Company engaged in manufacture, repair and overhaul activities viz., Helicopter (HCD), Overhaul (OHD) and Aero Engine Divisions (AED) in

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* *Local Area Network*

♠ *Wide Area Network*

Bangalore. The audit methodology adopted included collection of information through questionnaire, test check of the system at the data entry level and personal interviews with the officers of the IT/User Departments. The Stock Master and Purchase Order Progressing System (POPS) Module data pertaining to the period 2002-03 was analysed for ascertaining the existence, availability and completeness of data.

9.5 IT Resources

9.5.1 Hardware

There were 16 servers of HP 9000 make, using oracle software, located at Divisions and Corporate Office.

9.5.2 Networking

The Company completed the networking of its various Divisions/Offices/Bases with LAN/WAN at a cost of Rs.13.29 crore. Though the networking, completed in March 2003, provided for 5161 intranet and 609 internet nodes in 40 locations, only 1777 intranet and 298 internet nodes were populated. On the creation of excess network capacity by 65.57 per cent in intranet and 51.07 per cent in internet nodes, the Company stated (August 2004) that 5161 intranet nodes had been installed considering anticipated expansion and implementation of Enterprise Resource Planning (ERP) system. However, documented justification for estimation of 5161 nodes was not made available to audit. It was seen from the details of the LAN/WAN network available in the Divisions that due to non-compatibility between the Central and the LAN/WAN Server Systems, only 322 PCs had been connected to LAN/WAN in the Overhaul, Helicopter and Engine Divisions as of March 2004, against 832 envisaged, resulting in system capacity utilisation of only 39 per cent. Thus, the LAN/WAN networks established in these Divisions at a cost of Rs.2.53 crore had not been utilised optimally.

9.5.3 Application Software

Application software for various functions had been developed in-house, using different language tools (COBOL, C ++, Fox Pro, Oracle, etc). It was observed that:

(i) there was no standardisation or documentation in the development of the software;

(ii) systems were not integrated with other functional areas and

(iii) due to lack of interfacing of the Oracle and COBOL programmes, data available in the online Modules had to be keyed in again for batch mode processing every month in OHD resulting in non-standardisation of repetitive information and duplication of efforts, thereby increasing the risk of errors.

9.5.4 Control of IT Assets/infrastructure

The Company was adopting a mixed approach of centralised and decentralised procurement of IT assets. Notwithstanding the Company's reply (October 2004) that only the specific requirements of the divisions had been procured at divisional level while the procurement of the major IT resources was handled centrally, it would be advisable for the Company to co-ordinate centrally the specific requirements of the divisions for ensuring completeness in standardisation. Though the IT assets valued at Rs.3.07 crore in OHD, AED and HCD (31 March 2004) had been covered under the fixed assets registers, the I T Departments of the Divisions were not having any control over the

configuration/location of the various IT assets procured/positioned in different Functional Departments. As a consequence, monitoring, up-gradation and prevention of obsolescence was not possible.

The Company stated (August/October 2004) that a structured monitoring mechanism would be devised and divisions advised to use authorised software.

9.6 *IT Vision and IT Plan*

9.6.1 *Lack of I T Strategy and policies*

The Company in its IT Vision envisaged Information Technology as a business enabler to achieve enterprise-wide integration, seamless global communication, speed and agility, management of information resources, creation of knowledge database and achievement of cost effectiveness by streaming of business processes. Accordingly, IT plan was drawn up for various steps for implementation by February 2002 to achieve the objectives. However, IT policies were yet to be formulated and the internal audit of IT systems was yet to be conducted (October 2004).

The Company stated (October 2004) that the IT policy had been under formulation and that the internal audit of IT systems would be carried out.

9.6.2 *IT Steering Committee*

The IT Steering Committee, under the chairmanship of the Chairman, HAL and all the wholetime Directors, was formed in September 2001. The main functions of the Committee were to determine the overall objectives of the Company and define IT strategy; to build a bridge between strategic business planning and IT systems development; to formulate the IT plan; to decide on investments required for the execution of the IT plan and to monitor the implementation of the IT plan. Though the Committee was to meet every quarter in a year, it formally met only once in 2002-03 and twice in 2003-04. The Company contended that though IT Steering Committee meetings were not held, the IT-related matters were discussed in the monthly meeting of the wholetime Directors. This, however, diluted the mandate given by the Board to the IT Steering Committee viz. to focus specifically on IT-related issues.

9.7 *General Controls*

9.7.1 *Physical Access Controls*

The Divisions put in place various physical controls to protect the IT facilities from damage due to fire, power failure, etc. A review of the controls revealed the following:

(i) Server room of some of the divisions had either not been provided with fire extinguisher or, if installed, had not been revalidated on due dates.

(ii) Some of the automatic smoke detection/fire alarm devices, though installed in OHD, were not working.

(iii) The department was neither maintaining any documentation on fire extinguisher devices installed, dates of their calibration nor checking working condition of those devices.

(iv) In HCD computer stationery, waste cartons, etc., had been stored inside the main server room, exposing the IT Assets to the risk of physical safety and security.

(v) Though Divisions stated that their IT assets had been insured against fire risks in line with the Corporate Office circular of March 1979, there was no insurance coverage for IT assets in OHD/AED for the period 2004-05. Lack of proper physical safety measures exposed IT assets valued at Rs.2.14 crore to risk of physical safety and security.

The Company stated (October 2004) that fire extinguishers had since been provided in LAN/WAN system rooms and were getting revalidated once in six months; Capital budget proposals were made by OHD to replace the existing defective automatic smoke detection systems; the computer stationery/waste cartons etc., had since been removed from the main server room in HCD and insurance coverage of the IT assets had since been ensured in HCD, OHD and AED. The reply regarding provision of insurance coverage to IT assets in OHD/AED could not be verified in Audit for want of documentary support.

9.7.2 Logical Access Control

The access to the Main Server was enabled through user ID and password. The Head of IT Department and nominated officials were authorised to boot and shutdown the system on all working days and on some holidays when officials were required to work. On a review of the controls, following observations were made:

(i) the passwords were not getting changed at regular intervals.

(ii) in OHD and HCD the programmers were provided access to live data system, against acceptable system safety, through group user passwords and a single user ID/password which would enable all the users in a Module to access the database. This could result in unauthorised changes to the database, which would be difficult to locate for rectification.

The absence of a comprehensive password policy and logical access control mechanism rendered the system vulnerable to abuse besides making it difficult to fix responsibility in case of any manipulation/corruption of the database.

The Company stated (October 2004) that the users would be advised to change passwords regularly. It further stated that the issue would be covered in detail in the IT policy. However, IT policy was yet to be formulated (October 2004).

9.7.3 Unauthorised Access to Source Codes

IT department officials in OHD had free access to the source codes and the application programmes were modified based on the User Department's oral request and in some cases functional heads/programmers themselves were carrying out small changes on interaction with users. The modifications had neither been documented nor had a proper procedure for change management control been formulated. In the absence of proper change management control, the accuracy of change carried out and accountability for changes could not be ensured in audit.

The Company stated (August/October 2004) that the documentation requirement would be addressed during ERP Implementation. However, no mention was made of the risk of access to source codes.

9.7.4 Security policies

The Company was yet to formulate a well-defined security policy identifying the threat perceptions and safety measures. Even the Computer Security guidelines on the use of pirated software, periodical change of passwords, storage of top secret information in the computers, maintenance of audit trail, etc., issued by the Ministry of Defence in June 2001, for adherence by all Defence PSUs, were circulated by the CIO to the Divisions only in March 2004 at the instance of Audit. The Divisions were yet to implement the security guidelines, the fact of which was accepted by the Company (October 2004).

Desk-top servers for firewall/ antivirus, associated operating systems and antivirus package in the LAN/WAN servers were installed at 26 Divisions/locations through M/s. CMC Limited, Bangalore, at a total cost of Rs.99.27 lakh to protect the network database from external access. Separate connections had been provided for the Intranet and Internet users to ensure physical and logical isolation of the internal network (December 2003). It was, however, observed that in 13 out of these 26 Divisions/ locations, firewall was not working due to bug problem viz., system hanging or inconsistency in system operation.

The Company stated (August/October 2004) that the firewall had since been debugged and was under observation and that no adverse impact was noticed on the LAN/WAN systems during the period the software was being debugged.

9.8 Application Controls

The IT Modules for Integrated Material Management (IMM) functions were developed in-house in ORACLE RDBMS and were being used for online data capture, since 1997-98. IMM module comprised three sub-modules viz., Material Provisioning, Accounting and Control (MPAC), Purchase Order Progression System (POPS) and Stores Accounting and Control (STAC). Material Planning, Purchase and Stores Departments were using these modules. The Module-wise deficiencies in controls are discussed in the succeeding paragraphs.

9.8.1 Input Controls

Material Provisioning, Accounting and Control Module

(i) In Helicopter Division

(a) certain essential details viz. material code, name, procurement lead time etc. were not made compulsory while entering data for the preparation of Material Purchase Request (MPR) resulting in incomplete data base;

(b) based on the oral advice of the Purchase Department, MPRs were being deleted by Data Entry Operators, the authority for which should normally vest with Departmental Managers;

(c) the facility in the system to ascertain the details of materials due to be received was not being used. This could result in improper purchase decisions.

(ii) In Overhaul Division, though following facilities were available in the system these were carried out manually, resulting in their non-utilisation for decision-making.

(a) computation of probability factor ('P' factor) and net requirement of spares, (b) maintenance of materials stock cards (except for new projects like Mirage and Jaguar),

(c) preparation of procurement review forms and (d) monitoring the status of conversion of MPR to Purchase Order.

(iii) In Aero Engines Division

(a) the system was not designed with inbuilt checks to facilitate effective material planning in respect of shelf life items and critical spares;

(b) adequacy exercise in respect of Bought Out Finished goods, castings, forgings, raw materials for various projects and the preparation of procurement review forms were done manually and on stand- alone computers and not online.

(iv) In Helicopter and Aero Engine Divisions, there were no inbuilt checks in the process of generating MPRs, in order to avoid the import of items available in India. Though the Aero Engine Division had been exercising manual checks since 2002-03, the extent/effectiveness of the same could not be assessed in audit due to non-availability of required data in the system;

(v) The Bill of Materials (BOM) consisted of duplicate part numbers, duplicate material code and duplicate strip part numbers. Normally the quantity per unit was fixed projectwise and should not vary in the BOM. However, it was observed that against the duplicate part numbers, the customer-wise and project-wise quantity of net requirement was varying. For example, part No.122353 was duplicated five times in the BOM and net requirement/quantity indicated against duplication of part number was varying customer-wise and project-wise, indicating lack of integrity and reliability.

The Company stated (October 2004) that

(i) suitable locks would be introduced as a modification in the module to avoid any freak MPRs with incomplete data;

(ii) necessary documentation would be introduced for MPR cancellation/deletion and Integrated Material Management personnel had been advised to use the 'dues-in' screens in MPRs also; and

(iii) The facility for manual intervention in the areas of 'P' factor/net requirement computation, preparation of procurement review forms etc., was necessitated by the changing requirements of the customer.

The reply is not acceptable as manual interventions would result in non-utilisation of available facility in the module and cropping up of errors/delays.

Purchase Order Progression System Module

(i) Comparative statements were prepared manually as their preparation was not possible in the module in Helicopter Division.

(ii) In Overhaul and Aero Engine Divisions the payment data, already entered by the Finance Department on a stand-alone computer, was entered again by the Purchase Department in their system. This resulted in duplication of work.

(iii) Due to lack of validation check at the time of data input, vendor names and addresses were duplicated in the vendor master data with different vendor codes;

(iv) The system generated Purchase Orders without quantities due to non-incorporation of validation checks for quantities.

The Company stated (October 2004) that the module was being utilised for generating comparative statements on trial basis and that the instances of errors in the vendor code would be corrected by carrying out a review.

Stores Accounting and Control Module

(i) Store numbers 18 and 28 of the Helicopter Division were not using the facility available in the system to ascertain the missing vouchers. These stores keyed in the missing vouchers only on receipt of the monthly missing voucher statement from the Information Technology (IT) Department. Further, a review of the missing voucher statement revealed that missing vouchers for April 2003 (212 Nos.) and May 2003 (199 Nos.) were communicated by the IT Department only in July and August 2003 respectively. Out of the above, five Nos. (April 2003) and 23 Nos. (May 2003) were not keyed in at holding stores. Due to this, the database remained incomplete and the output generated lacked accuracy;

(ii) In Helicopter Division, though there was an inbuilt system check for the material code field through check digits, in the absence of proper validation checks for the purchase order number and voucher number fields, the system accepted seven digit and six digit numbers for these fields respectively.

(iii) In Helicopter Division, Inter Divisional Transfer Order (IDTO) had been placed on Aircraft Research and Design Centre (ARDC) for manufacture and supply of composite items and the IDTO covered only the labour component. It was observed that the physical receipts/issues/consumption of the composite material was being controlled by ARDC, which had been entrusted with the responsibility of fabricating and supplying the composite parts/structures to the Helicopter Division. During the year 2003-04, the Division charged off a sum of Rs.22.64 crore to consumption and cost of sales on an adhoc basis through a dummy work order based on the statistical information and Stock-in-Transit/Inter-Divisional Transfer Order (SIT/IDTO) bifurcation furnished by ARDC.

The Company stated (October 2004) that instructions had been issued to the concerned stores in Helicopter Division to use the missing vouchers query screen so as to avoid the incomplete data. It also assured that the system of receipts, acceptance and issue of composite material received from ARDC would be strengthened in 2004-05.

9.8.2 Process Controls

Material Provisioning, Accounting and Control Module

(i) In Helicopter Division, there was no MPR amendment screen. The corrections were carried out on the MPR screen itself and the system accepted modifications to an MPR already released;

(ii) In Aero Engine Division, proper checks were not available in the system to indicate the availability of common parts/material in the various project stores for arriving at the net requirement/ generating MPR and to avoid purchase of excess/unnecessary items. Though the system provided the

facility for ascertaining the details of common parts, the extent to which this facility was used by the user departments was not assessable;

(iii) In Aero Engine Division, a separate module to facilitate the computation of the net requirement for given tasks and to plan the procurement action had not been designed and put in place. Due to this, project-wise Bill of Materials, the details of previous consumption which facilitated probability factor calculations, the project-wise/ customer-wise task data in respect of repair/overhaul activity, Aircraft on ground orders, defect investigation, customer complaints and actual deliveries, which were important for material planning, were not captured/maintained on line.

The Company stated (October 2004) that the MPR amendment screens had since been introduced. As regards the non-utilisation of the common parts query screen the Company stated that the common parts were negligible and C class in nature. The reply is not acceptable as the system ought to have provided inbuilt checks to indicate the availability of common parts and the common parts query screen needed to be utilised to ensure proper material planning.

Purchase Order Progression System Module

An analysis of the data on Purchase orders (PO) made available to audit, revealed that:

(i) In Helicopter Division, the PO and MPR date fields were blank in 8,632 and 2,700 cases respectively as the date fields were not devised as mandatory data entry fields. In 4,994 out of 11,660 cases, delay in converting MPRs into POs ranged from one day to 1,511 days over and above the 90 days time allowed ;

(ii) A review of the POs closed during 2002-03 revealed that 5,489 POs valued at Rs.217.67 crore were pending from 1998 and onwards. As the delivery had fallen overdue in many of these POs, action was required to be taken either to obtain the deliveries or to cancel these POs;

The Company stated (October 2004) that the audit observations were noted for review and remedial action.

Stores Accounting and Control Module

(i) In Overhaul Division the data relating to Receiving Report number (RR No.) and date, purchase order number, quantity received and material code, which were entered initially by the Receiving stores, were keyed in again by Holding stores and by Bills Payable Section. The data already available in the module were also keyed in again every month for batch processing by the Information Technology Department, resulting in duplication of work, waste of resources and errors due to lack of compensating controls/checks;

(ii) In Helicopter Division, assigning a single material code for both the 2B1 and 2B2 models of the Turbomeca Engine resulted in non-inclusion of inventory value of five Numbers of 2B1 engines lying in the shop floor. This resulted in overstatement of consumption and understatement of inventory to the extent of Rs.4.87 crore during the year 2001-02 which was adjusted subsequently (September 2003). This is indicative of the absence of proper controls in the

matter of analysing and authorising the adjustment of negative balances highlighted by the system.

The Company stated (October 2004) that the audit observation regarding analysing and authorising the adjustment of negative balances had been noted for review and necessary action.

9.8.3 Output Controls

Material Provisioning, Accounting and Control Module

In Helicopter Division, the periodicity for review and updation in respect of output generated through the module was not documented. The existing recommendations were updated in October 2000. However, taking into account the wide differences in the existing Ten-off list (the list of spares specifying probability factor in respect of spares used for Helicopter overhaul) and the recommended Ten-off list in respect of certain parts, the recommendations were required to be updated every year.

The Company stated (October 2004) that it proposed to update the Ten-off list, which was being updated once in five years, during 2005. It was, however, observed that the Company did not have a laid down policy stipulating five year duration for updation of the Ten-off list. Considering the wide variations between the existing Ten-off list and the recommended Ten-off list, it is imperative that such an exercise is done annually so as to enable proper procurement planning.

Purchase Order Progression System Module

(i) In Aero Engine Division, though a Monthly Summary Report of time taken for conversion of Material Purchase Request into purchase orders was generated, it was seen that delays of more than 90 days continued;

(ii) In Aero Engine Division, the soft copies (in compact discs/floppies) of data and other information were being routed by the IT Department through Functional/Finance Departments which, besides entailing unwarranted delays, prevented audit from obtaining a reasonable assurance on the ability of the system to provide complete, accurate and reliable data at any point of time. However, the fact that the Purchase Department had sent back the Module data to the IT department for error correction/updation indicated that the system had not been tuned to provide reliable, accurate and complete data at any given point of time.

The Company stated (October 2004) that the observations were noted for improvement.

Stores Accounting and Control Module

(i) In Helicopter Division, as the Module did not provide for online generation of Part Disposition Orders and Lab Test Request forms, these were prepared manually by Inspection Group.

(ii) The cut-off date fixed for generating outputs under the module by the Information Technology Department to be given to Material Accounts Section was stated to be the 20th of every month for Helicopter Division and the sixth of every month for Overhaul Division. Though Aero Engine Division had not indicated any cut-off date, the date fixed by Overhaul

Division was reckoned for this Division also. Though there was no documentation in any of these Divisions to monitor the movement of the output, a test check revealed that there were delays in making the output available to Material Accounts Section in all the three Divisions. Consequently the closing inventory furnished to the Divisional Committee of Management during their monthly meetings was at variance with the actual inventory as per stock master data.

The Company assured (October 2004) that (a) the online generation of Part Disposition Orders and Lab Test Request would be facilitated in the module (b) the strict adherence of the existing cut-off date would be ensured among all the divisions and (c) action for data cleansing would be taken up.

9.9 Lack of adequate disaster recovery and business continuity planning

Though backup of data was taken on weekly basis, except in AED, they were stored in the same site where the computer system was available. In the absence of a disaster recovery plan in the Divisions, any significant disaster impacting the data volume covering 34 GB (approximately) would paralyse automated operations of the Divisions.

The Company stated (August 2004) that the disaster recovery plans would be covered as a part of IT policy, which was yet to be formulated.

9.10 Material Accounts

An analysis of inventory data revealed the following:

9.10.1 Negative Balances in the Material Ledger

The material ledger, which was processed and printed once a month, was found to contain negative balances against several material codes. The reasons for negative balances and system control check deficiencies are given below:

(i) Where the quantity issued was more than the quantity at stock, instead of rejecting the input the system was accepting the entry, which had to be corrected manually by comparison with bin card statement.

(ii) The negative balances in the value suspense would be reversed if it was proved that where the quantity issued should not have been priced was priced, due to programme logic and thereby wrong process;

(iii) Any negative quantity appearing in the ledger would be removed without analysing reasons therefor, where the value was less than Rs.50,000.

(iv) Where Material Requisition (MR) was accounted prior to RR and MR was more than the stock, instead of rejecting the input, the entry system accepted it.

(v) An illustrative case showed that adoption of divergent practices in passing adjustment entries treating non-priced quantity as priced, resulted in carrying of inventory with value which had simultaneous impact on valuation of Work in Progress and transfers to Cost of Sales.

A comparison of the negative balances as per monthly Debit/Credit Balance Ledger and the Value Suspense as per monthly Stock Master (cumulative) for the year 2002-03, in HCD, revealed differences of around Rs.10 crore every month, which represented the

unadjusted balances pertaining to the previous months. This indicated that all the negative balances were not reviewed and adjusted in the next month. The total value of the transactions passed through code No.575 and 626 for adjusting the negative balances, during the years 2002-03 and 2003-04 amounted to Rs.51.38 crore and Rs.67.47 crore respectively.

The Company stated (October 2004) that the entire negative balances appearing during 2002-03 had been reviewed and corrected and that review and rectification of value suspense on a monthly basis would be undertaken as suggested. However, the Company's reply was silent about removal of negative balance below Rs.50,000. The accuracy of adjustments to correct negative balance could not be verified in Audit in the absence of documented analysis.

9.10.2 Non-moving Inventory – System deficiency in classification

As per the prevalent system, the division prepares list of non-moving and slow-moving items for the purpose of monitoring movement of inventory and for analysing the reasons for their non/slow movement. The Company provided for 100 per cent value of the non-moving inventory aged more than five years in the accounts. A specific field was available in the data table for storing the last issue date. The system had been programmed to identify non-moving item, wherever the last issue date of that material code was more than five years.

An analysis of the data on non-moving items as on 31 March 2004 revealed that the system had been programmed to compare the date of last issue only, ignoring the date of receipts. This resulted in system identifying inventories aged less than five years also as non-moving items. This deficiency resulted in creating 100 per cent redundancy provision even on new procurements not falling within the five year criteria. On test check of a few such items, the 100 per cent redundancy provision made, amounted to Rs.25.41 lakh (2002-03), Rs.16.65 lakh (2003-04) in HCD and Rs.34.84 lakh (2002-03) in OHD.

The Company (October 2004) agreed with the facts and stated that the system would be reviewed for proper accounting.

9.10.3 Erroneous computation of Weighted Average Rates

In Helicopter Division, items found to be defective, after acceptance and issue for assembly, were being sent to the suppliers for repair. However, the value of these items which were already charged off to consumption, continued to remain under work-in-progress. The suppliers carried out the repair free of charge, if the items were within the warranty period or on chargeable basis, if the warranty period had expired. On receipt of the repaired item from the supplier, the Division prepared a fresh Receiving Report (RR) and the item was valued either at 'Nil' value or with the repair charges incurred. The system picked up the repaired item along with the repair charges as a fresh addition and computed the Weighted Average Rate of the entire quantity lying in inventory. This distorted the unit rate adopted for the subsequent issues.

For instance, TM 333 2B2 Engine No.1054, was found to be defective (March 2003). after issue (December 2002) against an Advanced Light Helicopter work order. The engine was sent to the supplier for repair even while the original value of Rs.2.03 crore was lying in work-in-progress (February 2003). When the engine was received after

repair (November 2003), it was accounted as a fresh receipt with the value of Rs.37.17 lakh in the material ledger, without any link to its original value viz. Rs.2.03 crore.

This system deficiency is required to be corrected, so as to ensure that the value of the material items sent back to the vendor for repair is brought to inventory through store credits and kept under a distinct material code so that proper linkage of the repair cost to the original value of the material is ensured in the Stock Master data.

Further, though shelf life-expired items were physically segregated immediately on the basis of Part Disposition Orders raised by the Inspection Department, it was observed in Overhaul, Helicopter and Aero Engine Divisions that the value was removed from the material ledger only when the disposal orders were issued by the Inspection Department to salvage stores. Delay in the removal of the value of the shelf life expired items from the material ledger affected the weighted average rate of the material issued during the intervening period.

The Company accepted the facts and stated (October 2004) that corrective action had been ensured.

9.10.4 Stock Masters – Absence of system review and cleansing

Analysis of the Stock Masters of Overhaul Division, Helicopter Division and Aero Engine Division revealed that:

(i) though the Divisions used a 12 digit Rationalised Code for material, the same had not been implemented in the computerised environment, as codification of all the materials was not complete. Wherever the new 12 digit material code was not provided, old code had been used. In many cases the system accepted the material codes which were less than 12 digits;

(ii) in the case of common materials, though the part number and part name were the same, different material codes had been assigned in different stores/projects (AED); and

(iii) in the case of 8,484 material codes where non-priced quantity was '0', there was a difference between the quantity priced in the Stock Master and the Bin Balance. The value of such excesses and shortages in the Stock Master as compared to the Bin Balance worked out to Rs.13 crore and Rs.12.83 crore respectively, resulting in a net excess inventory of Rs.17 lakh. Though in the case of inventory items individually valuing more than Rs.50,000, differences between Bin Balance and Stock Master were analysed and adjustments carried out, in 643 cases of inventory (value higher than Rs.50,000) the differences between Bin Balance and Stock Master still persisted (AED).

In the absence of cleansing of Stock Master for deletion, proper/complete codification of materials, Audit could not vouchsafe the completeness, accuracy and reliability of the database.

The Company accepted the facts and stated (October 2004) that the point had been noted for necessary action.

9.10.5 Common Materials – system deficiency in inventory control and accounting

The common materials used in different projects /stores were separately maintained in the Stock Master, though the material and the material code was the same. The discrepancies

noticed in HCD and AED consequent on keeping materials having same code/nomenclature in different stores and under different projects, are detailed below:

(i) As the weighted average rate of a material code had been calculated project/store-wise, different weighted average rates were assigned to the same material available in different projects / stores.

(ii) As the non-moving inventory was also calculated based on 18 digit code, it would result in a situation where an identical material moving in one store might be classified as non- moving in another store. This would, consequently, result in excess provisioning for non-moving inventory. A test-check revealed that items valued at Rs.81 lakh were exhibited as lying under non-moving inventory though these items were moving in other projects/stores, as on 31 March 2003 in HCD.

This system deficiency needed to be corrected to ensure proper valuation of inventory and to obviate the possibility of procurement of a common material that might be available and non-moving in other projects/stores and the consequent blocking of inventory.

The Company accepted the facts and stated (October 2004) that the point was noted for necessary action.

9.11 Implementation of Enterprise Resource Planning (ERP) System

9.11.1 The IT Plan envisaged (September 2001) the implementation of the Pilot Project of ERP (HCD and Corporate Office) by December 2003 and Company-wide implementation of ERP by June 2004, at an estimated cost of Rs.22.30 crore. An IT core group was formed (July 2002) with the IT Consultant as a co-opted member to study various ERP packages available and to submit a report for selection of suitable ERP package by August 2002 to the Committee of Directors (CoD) for selecting and implementing suitable package. After short-listing ERP package and taking into consideration the report submitted by IT Core Group, Industrial Financial System – Enterprise Resource Planning (IFS-ERP) package was selected (March 2003) for implementation only in June 2004. As per the IT Plan, the implementation should have been completed by June 2004. M/s. BAeHAL was awarded (June 2004) the order for Rs.8.93 crore for implementation of ERP in three pilot sites initially and in 14 roll-out sites subject to successful completion/implementation of IFS-ERP packages at all three pilot sites.

The Company stated (August/October 2004) that the selection of ERP package involved study of available packages, their merits/demerits, suitability for the organisation's business processes etc. The Company, therefore, contended that the time taken was considered reasonable. However, the Company should have given due weightage to all the factors at the time of planning.

9.11.2 The Management agreed to take corrective steps during implementation of ERP in respect of the following deficiencies pointed out by Audit in the existing system.

(i) Non-utilisation of LAN/WAN networks to the full extent. (para 9.5.2)

(ii) No standardisation or documentation in the development of the software, non-integration of systems with other functional areas and lack of interfacing of the Oracle and COBOL programmes. (para 9.5.3)

(iii) Programmers were provided access to live data system through group user passwords. (para 9.7.2 and 9.7.3)

(iv) No inbuilt checks were available in the process of generating MPRs, to obviate/restrict the import of indigenised/ fabricated items. (para 9.8.1- MPAC (iv))

(v) BOM consisted of duplicate part number, material code and strip parts. (para 9.8.1 MPAC(v))

(vi) Duplication of vendor names and addresses figured in the vendor master. (para 9.8.1-POPS (iii))

(vii) Non-integration of the data resulting in wrong computation of net requirement. (para 9.8.2-MPAC)

(viii) Duplication of data entry due to lack of compensating controls. (para 9.8.2-STAC)

(ix) Implementation of required controls. (para 9.8.3 -STAC)

(x) Negative balances in the material ledger due to deficiency in program logic. (para 9.10.1)

9.12 Conclusions

(i) The Company was yet to formulate its IT Policy.

(ii) The IT Steering Committee meetings were not held, as prescribed.

(iii) The IT infrastructure monitoring and control were not vested with the IT department and the audit of the IT systems/functions by internal audit/ system audit had not been ensured.

(iv) The application software were not standardised. Integration of various functional applications and proper interfacing of ORACLE and COBOL applications had not been ensured.

(v) There was absence of a well laid-down password policy and logical access control mechanism, rendering the system vulnerable to abuse besides making it difficult to fix responsibility in case of any change in and manipulation/corruption of the database.

(vi) The Company had been using IT resources only for transaction processing. The resources were not being utilised for decision-making and monitoring purpose. Unless a better integrity level of data is established and the general and application controls are toned up, the correctness and completeness of data capture/updation and availability, accuracy and integrity of the database cannot be ensured.

(vii) The IT system had not served the purpose of fulfilling the objective of IMM due to various deficiencies in various modules as well as practices followed.

9.13 Recommendations

(a) IT policy should be formulated immediately and internal audit of the IT Systems carried out.

(b) Well-defined security policy identifying the threat perceptions and safety measures should be formulated.

(c) Free access to the source codes should be avoided.

(d) There should be comprehensive password policy.

(e) The Company should have adequate disaster recovery plan in place to protect the data.

(f) An Enterprise Resource Planning system, which can take care of problems and deficiencies in the existing system, needs to be implemented expeditiously.

The review was issued to the Ministry in November 2004; its reply was awaited (March 2005).

DEPARTMENT OF ECONOMIC AFFAIRS-INSURANCE DIVISION

CHAPTER : X

National Insurance Company Limited
Oriental Insurance Company Limited

Special contingency policies on mobile handsets.

Highlights

Two insurance Companies suffered heavy losses in the issue of tailor made insurance policies because of non-compliance to technical parameters and non-evaluation of risk factors involved.

(Para 10.4)

The failure on the part of the Management to obtain reinsurance protection, ensure the compliance of Insurance Regularity and Development Authority (IRDA)/ General Insurance Public Sector Association (GIPSA) guidelines as well as non-inclusion of the loading clause deprived the Company of the opportunity to reduce its losses in all the Special Contingency Policies (SCPs) issued during 2002-03 to 2004-05.

(Paras 10.5.2, 10.5.3, 10.5.4 and 10.5.6)

In handsets all risk cover issued under SCP on 18 December 2002 to Reliance Industries Limited (RIL), National Insurance Company Limited (NIC) received claims for Rs.91.23 crore upto October 2004 against the premium of Rs.27.39 crore (excluding service tax) realised during December 2002 to October 2004. Out of these, it settled claims for Rs.24.69 crore and the balance claims for Rs.66.54 crore were pending settlement.

(Para 10.5.6)

In the default policy issued to RIL on 25 June 2003, NIC received claims for Rs.152.34 crore against the premium of Rs.55.71 crore realised upto October 2004. Out of these it settled claims for Rs.120.60 crore and the balance claims for Rs.31.74 crore were pending.

(Para 10.6.3)

In the default policy issued to Tata Tele Services Limited on 1 April 2004 NIC received claims of Rs.9.54 crore against the premium of Rs.6.20 crore realised upto October 2004. Out of these, it settled claims for Rs.3.42 crore and the balance claims for Rs.6.12 crore were pending.

(Para 10.7)

In the default policy issued by OIC in August 2003 to RIL for handsets the insured reported 61193 claims for Rs.63.53 crore. The Company had so far settled 18706 claims for Rs.19.64 crore and balance claims involving estimated outgo of Rs.13.81 crore, after taking into consideration repudiated claims, were pending.

(Para 10.8)

NIC failed to arrange the reinsurance protection. With a view to finance the huge flow of claims, it obtained Alternate Risk Transfer (ART) cover from foreign reinsurer and paid Rs.13.38 crore as one time upfront fee. This upfront fee further reduced the already low premium income.

(Para 10.9)

10.1 Introduction

General Insurance business is traditionally divided into Fire, Marine and Miscellaneous. Miscellaneous insurance includes in its scope Special Contingency Policy (SCP) or tailor-made policy. The risks associated with 'Mobile handsets', which could not be covered under the standard policies, were covered under SCP. SCP covers were issued to dealers and manufacturers.

The Mumbai Divisional Offices of the National Insurance Company Limited (NIC) issued two policies in 2002-03 and 2003-04 respectively to the Reliance Industries Limited, Reliance Infocom Limited and its associates (hereinafter referred to as RIL) and one policy to Tata Tele Services Limited during the year 2004-05 and the Mumbai-based Divisional Office of the Oriental Insurance Company Limited (OIC) also issued a policy during the year 2003-04 to RIL to underwrite the risks associated with mobile handsets without careful evaluation of the risk involved and other technical aspects, which resulted in heavy losses to these companies.

10.2 Scope

The review of the insurance cover issued by the Mumbai-based Divisional Offices of NIC and OIC during the years 2002-03 to 2004-05 to cover the risks related to mobile handsets under SCPs was conducted during the period from September 2004 to November 2004.

10.3 Audit Findings

An analysis by Audit of the insurance policies under SCPs revealed that they were devised primarily to suit the requirements of the insured, without safeguarding the insurers' interest owing to non-adoption of the prudent underwriting guidelines as brought out in the succeeding paragraphs.

10.4 Non-evaluation of technical aspects

Before issuing the SCPs, all the operating offices were required to comply with the following technical parameters to ensure that the risk would not make the rating unviable:

(i) Prior sanction of the Reinsurance Department of the Company to be obtained before acceptance of risks beyond the prescribed limits, as advised by Reinsurance Department from time to time.

(ii) The excess clause* must be clearly indicated against each item or section.

(iii) Basis of sum insured i.e. whether market value, reinstatement, replacement, non-recoverable cost etc. as applicable, to be indicated to avoid disputes.

** Excess clause means that part of loss, which would be borne by the insured in order to avoid high frequency low value losses/claims to be paid by the insurer.*

(iv) In case of non-standard products/risks like financial risks, asset protection and stock exchange risks, the pricing, terms and conditions should be in line with the requirement of reinsurer as contemplated in the Company's reinsurance programme.

However, an analysis in audit revealed that during the course of finalisation of terms and conditions of policy documents for the issue of insurance cover for SCP for the mobile handsets by the operating offices of NIC and OIC, the above-cited instructions were not complied with as brought out in paragraphs 10.5.2 to 10.5.4, 10.6.1 and 10.6.3.

10.5 Handsets all risks cover with RIL

The Kalyan Divisional Office (D.O) under the Mumbai Regional Office (R.O)-I of NIC, issued a SCP for mobile handsets on 18 December 2002 to RIL, which was valid for three years, based on a Memorandum of Understanding (MOU) signed on 6 December 2002 with RIL. It covered the risk of physical loss or damage to the mobile handsets necessitating repair and fraudulent use consequent upon misplacement/theft, suffered by the persons to whom the mobile handsets were sold by the insured, subject to a maximum of Rs.12,000 per accident. Premium at the rate of 0.25 per cent per annum was charged on the declared sum insured.

The salient features of the MOU were as under:

(i) The policy was issued with the concept of periodical increase in sum insured by progressive coverage.

(ii) Either side (insurer or insured) might cancel the policy by giving seven days notice in writing.

(iii) The insured would undertake periodic declaration of invoice number, date of sales, value, and details of customer (name, city) to the insurer;

A review of the MOU referred to above revealed that the following important guidelines were not followed by the operating offices:

10.5.1 Approval from Head Office:

As per NIC's guidelines issued in March 1999 the power to develop a new product under SCP was retained with the Head Office of the Company. The Kalyan D.O. based on MOU dated 6 December 2002 with RIL, devised a new SCP to cover the loss or damage to the mobile handsets involving repair and fraudulent use. Being a new product, it required approval of headquarters before its implementation. However, this was not obtained before its implementation.

Besides this, as per Company's guidelines all fresh proposals under SCP where the sum insured exceeded Rs.50 lakh were to be referred to Head Office for approval. However, Kalyan D.O issued the above-cited SCP for mobile handsets for the sum insured of Rs.6.50 crore with a clause that sum insured would increase with subsequent sales of mobile handsets upto the expiry of period of the policy i.e. 17 December 2005. As the sum insured had far exceeded the prescribed limit of Rs.50 lakh, the Kalyan D.O, by not obtaining prior approval of Head Office, had exceeded its powers.

10.5.2 Re-insurance protection:

The Company every year draws up its reinsurance programme for various classes of risks in order to fix retention limit of risks commensurate with its financial strength. Insurance Regulatory and Development Authority (IRDA) guidelines also stipulate that the maximum loss retention should not exceed five per cent of the networth of the Company. However, the D O did not make any reference to Re-insurance Department for taking reinsurance cover. In the absence of this, the risk retention limit could not be calculated. The sum insured as on 31 October 2004 was Rs.3850 crore (and would increase further as validity of the policy was upto 17 December 2005). Thus, there was no reinsurance to protect the Company's risk except 20 per cent obligatory share of risk accepted by the General Insurance Corporation (GIC). The GIC allowed 25 per cent commission on premium received on account of obligatory reinsurance.

10.5.3 Absence of risk analysis

As per IRDA guidelines NIC was to indicate how the products would be priced, the database that would be used to determine the premium basis and the terms and conditions and the statistical system that would be established to review the adequacy of rates. NIC did not make any exercise based on statistical data of similar industry to evaluate the adequacy of rating and risk involved.

10.5.4 Absence of viable clause of loading.

As per General Insurance Public Sector Association (GIPSA) guidelines circulated by the Company in June 2001, the rates quoted were to be suitably loaded based on claims experience of each year so as to bring the incurred claim ratio to 70 per cent in case of adverse claims. However, the policy was issued on long-term basis for three years without inclusion of above-cited clause, which ultimately made the rating of the policy unviable.

10.5.5 Inaccurate pricing

In March 1996 the Company formulated a scheme for wholesalers/dealers/manufacturers for normal coverage of damage and theft of mobile phone on trial basis for a period of one year at a suggested rate of 0.25 per cent per annum. Although the scope of risk involved in the SCP for handsets policy issued to RIL was increased to cover the new element of loss due to fraudulent act in addition to normal losses on account of damage and theft of mobile phone, the Divisional office of NIC did not charge any premium for the additional coverage of risk. This resulted in extending undue benefit to the insured.

10.5.6 Non-invoking of cancellation clause

As per clause eight of the MOU entered into between NIC and RIL there was a provision for cancellation of policy by giving seven days notice to the insured. Despite the number of deficiencies in the implementation of the terms and conditions of the MOU, NIC did not invoke the cancellation clause. The reasons to justify the non-invoking of the cancellation clause were not available in the records made available to Audit.

The technical department of Head Office observed in February 2003 that the operating office should have included a suitable clause for rapid obsolescence of the equipment and fall in its market price, unexplained losses/malicious act and settlement of claims on market value basis after deduction of depreciation. By not referring the above policy to

Head Office for their technical concurrence, the above-cited aspects were left out of the policy conditions.

The failure on the part of the Management to obtain reinsurance protection as well as non-inclusion of the loading clause deprived the Company of the opportunity to reduce its losses. As a result of this, against the premium of Rs.27.39 crore (excluding service tax) realised during December 2002 to October 2004, it received claims for Rs.91.23 crore upto October 2004. Out of these, claims for only Rs.24.69 crore were settled and the balance claims for Rs.66.54 crore were pending settlement. On the basis of paid/outstanding claims after taking into account premium ceded and commission received on account of reinsurance the Company had suffered a loss of Rs.63.84 crore (NIC Rs.49.70 crore and GIC Rs.14.14 crore).

10.6 Default policy issued to RIL

Based on another MOU entered into between NIC and RIL on 25 June 2003, the Kalyan DO issued an SCP to RIL to cover the default liability risk in respect of mobile handsets for the period from 25 June 2003 to 24 June 2006. The premium rate per handset/connection was charged at Rs.100 (including eight per cent service tax). The scope of cover included net ascertained financial losses arising out of telecom services of the insured and/or cost of the handset from default due to fraudulent activity of the subscriber subject to a maximum loss of Rs.11,000 per handset. The fraudulent activity included default of periodical payment/dues by the subscriber for any reasons whatsoever. Further, the parties had no option to cancel the policy during the validity period of the policy.

A review of records relating to the underwriting of the risk under this default policy revealed the following deficiencies that led to huge losses to the Company:

10.6.1 Non-conventional Policy

The SCP for handsets issued in 2002 covered the risks of damage/theft suffered by the users on account of fraudulent use of the handsets consequent on misplacement/theft. The Kalyan D.O, based on the MOU signed in June 2003, devised a new product enlarging the scope of risk. The cover was given to RIL with sum insured of Rs.5500 crore to indemnify their financial loss on account of default of periodic payment/ dues by the subscribers for any reasons including fraudulent activity. This type of non-conventional policy covering financial risk was issued for the first time in the Indian market. Despite the substantial increase in the amount of the sum insured over the prescribed limit of only Rs.50 lakh, the Kalyan D.O in this case also did not obtain the approval of Head Office before issue of SCP for default cover for handsets. Thus, the same D.O exceeded its powers in issuing the above-cited cover.

In this context the Head Office of NIC also observed while reviewing the policy in March 2004 that any non-conventional, tailor-made or contingency proposal should not have been committed without its authorisation and more serious thought should have been given and prudence should have been observed in ascertaining the aggregate risk exposure.

10.6.2 Absence of reinsurance protection

As already mentioned as per IRDA guidelines and the Company's reinsurance programme, the Company, before undertaking any cover, must obtain reinsurance

support. However, the Kalyan D.O. in the instant case of 'Default cover policy' also did not take any reinsurance protection before issue of the policy, even though the aggregate sum insured was Rs.5,500 crore.

10.6.3 Deficiencies in MOU

(a) No clause for cancellation

In the earlier MOU (December 2002) entered into between NIC and RIL, there was a clause for cancellation of policy by giving seven days notice in writing by either side. In the MOU dated 25 June 2003, however, this condition was excluded. Thus, the Management had forgone the right to take any remedial action. As a result, the Company would be bound to accept claims under policy endorsements issued upto 24 June 2006.

(b) No provision for loading and periodic review

Despite the Head Office specific instructions of February 2003 that the SCP in any case should be renewed on yearly basis, this provision was not considered in the MOU entered into with RIL in June 2003. The default policy was issued to RIL for three years without any provision for periodic review of premium including loading factor for adverse claims.

(c) Risk coverage beyond the scope of MOU

The D.O. had also extended the risk coverage to coloured handsets by charging premium of Rs.140 per set (including service tax) with a sum insured of Rs.24,000 per set and thereby increased the total sum insured from Rs.5,500 crore to Rs.6,150 crore, even though no such provision existed in the MOU.

(d) Absence of excess clause

No excess clause to limit the overall loss amount was included in the MOU in order to minimise/restrict the loss of the Company.

In view of the deficiencies narrated above, NIC received claims for Rs.152.34 crore against the premium of Rs.55.71 crore upto October 2004. The Company settled claims for Rs.120.60 crore and the balance claims for Rs.31.74 crore were pending. Though the currency of policy was three years, the liability of the Company would extend beyond the stipulated period as each policy endorsement carried coverage period of three years from the date of issue. As such the Company would be liable for any future default/claims upto June 2009. On the basis of paid/outstanding claims after taking into account premium ceded and commission received on account of reinsurance the Company had suffered a loss of Rs.96.63 crore (NIC Rs.74.51 crore and GIC Rs.22.12 crore) upto October 2004.

The request of the Management to RIL for enhancement of premium in April 2004 stating that pricing done was not proper considering the nature of risk and that the magnitude of loss would reduce the networth, substantiated the audit findings.

10.7 Default Policy with TATA TELE Services Limited

While the Company had already suffered huge loss in underwriting the default cover of RIL at a very low premium as mentioned above, the Mumbai based Divisional Office under the same Regional office entered into MOU on 1 April 2004 for a three year period with TATA TELE Services Limited for giving default cover similar to the cover given to RIL. The premium rate was Rs.92 (excluding service tax at fixed rate) for one year

instead of three years in the case of RIL. In the issue of insurance cover to TATA TELE Services Limited also NIC committed the deficiencies as brought out in paragraphs 10.6.2 and 10.6.3 (a) and (d).

NIC had received claims of Rs.9.54 crore, against the premium of Rs.6.20 crore realised upto September 2004. The Company had settled claims for Rs.3.42 crore upto October 2004 and the balance claims for Rs.6.12 crore were pending, based on settled/outstanding claim position after taking into account premium ceded and commission received on account of reinsurance the Company had suffered a loss of Rs.3.34 crore (NIC: Rs.2.37 crore and GIC: Rs.97 lakh) on this policy. This indicated that the company had been venturing to underwrite risks even though it was clear that this would be a loss-making portfolio.

10.8 Default Policy issued by the Oriental Insurance Company Limited

The Oriental Insurance Company Limited (OIC) also agreed (August 2003) to underwrite the default insurance policy covering the period from 1 August 2003 to 31 July 2006 with RIL at the agreed rate of Rs.92+ Service Tax of eight per cent. In the issue of default policy cover to RIL, OIC committed the same deficiencies as brought out in paragraphs 10.6.1, 10.6.2 and 10.6.3 (a) and (b) viz. not obtaining approval of H.O., absence of reinsurance protection, non-inclusion of cancellation clause and non-provision for periodic review.

The gist of OIC replies (December 2004) to paragraphs 10.6.1, 10.6.2, and 10.6.3 (a) and 10.6.3 (b) and the audit comments thereon are given below:

(i) While accepting the fact that such cover was issued for the first time OIC stated that the policy was issued by the Regional Office (RO) after exercising due diligence and the detailed information was sent to Head Office for information and necessary action

The above contention of OIC is not tenable as many claims were subsequently found to be false and were repudiated due to non-existence of the subscribers at the given addresses. Inclusion of persons who had not subscribed to Reliance mobile services substantiated the fact that due diligence was not exercised by the Company before the issue of the policy to the insured.
Further, the contention of OIC that the detailed information was sent to Head Office for information and necessary action is also not acceptable as in the absence of the details as to when the matter was referred by the R.O. to the Head Office (H.O.) and the action by the H.O. thereon before the issue of the policy, the correctness of the facts stated in the Management's reply could not be verified in Audit. Some suggestions sent by the H.O. after the issue of the policy i.e. on 9 August 2003 on inclusion of the cancellation/claim procedure clauses were also found not complied with.

(ii) The contention of the Management with regard to para 10.6.2 that the Company did not take reinsurance protection before the issue of the policy cover as it treated each connection as an independent risk and not as an aggregate risk is not tenable because sum insured under SCP for 'Default Insurance Cover' issued to RIL-Mumbai for Rs.6150 crore covering 50 lakh mobile handsets substantiated that the risk was treated as an aggregate risk and not as an independent risk. Further, the total risk under the policy which is spread all over the country is similar to floater policy where-under aggregate of risk is considered as a single risk irrespective of their location. On the analogy of floater

policy approval from competent authority should have been taken, considering need for reinsurance and underwriting the aggregate risk.

(iii) In reply to para 10.6.3. (a), the Management stated that they had included the cancellation clause to protect their interest. The above contention of the Management is not correct because as per terms of the cancellation clause included in the insurance policy the insurer and the insured had agreed to waive any right of cancellation of the insurance agreement for a period of three years. Thus, the option for cancellation could be exercised only after expiry of three year period of the policy. It shows that the Management cannot cancel the insurance policy during the currency of policy to protect its interest.

(iv) In reply to para 10.6.3. (b), the Management stated that since it was the first policy of its kind underwritten by them it did not have the features like review, which was normally incorporated on renewal of a policy if claim experience was adverse. The above contention of the Management is not acceptable because as per the general rules and regulations of insurance no insurance may be granted for a longer period than one year. Thus, the Company should have included the provisions for review of the premium/ adverse claim ratio on yearly basis instead of for three years.

The business results available upto December 2004 indicated that the Company could get premium of Rs.17.02 crore (excluding service tax). The insured reported 61193 claims of the total handsets for Rs.63.53 crore covered under the default cases upto November 2004. Out of 61193 claims reported, verification of 53670 claims was carried out by the investigator appointed by the Company upto February 2005 by incurring an expenditure of Rs.3.76 crore. Based on verification report of the 53670 claims given by investigator, the Company repudiated 29,334 claims for Rs.30.08 crore on the grounds of (i) non-existence of addresses (3278 claims) (ii) non-existence of persons at the given address (16289 claims), (iii) persons not subscribed to Reliance Mobile (5438 claims), (iv) persons moved away from the given address (3345 claims) and (v) continuance of mobile service even after default (984 claims) and settled 18706 claims of Rs.19.64 crore in aggregate. The balance 13,153 claims of Rs.13.81 crore were outstanding for want of further verification.

Based on the current claim settled/outstanding after taking into account premium ceded and commission received on account of reinsurance, OIC has suffered a loss of Rs.16.05 crore (including investigation charges) and GIC a loss of Rs.4.14 crore.

10.9 Alternate Risk Transfer

The Alternate Risk Transfer (ART) cover is generally taken where substantial losses are apprehended. The main object of ART cover is risk financing and not risk-sharing. The default cover policies were given to RIL without any reinsurance protection. After steady flow of claims, the Company searched for reinsurance protection but could not arrange any conventional reinsurance. Ultimately, through broker, it could obtain non-conventional risk financing under ART protection from foreign reinsurer. Under the ART cover, insurer (NIC) would require to pay back the entire amount received from reinsurer to settle claims within two to three years to smoothen the effect on balance sheet.

NIC paid Rs.13.38 crore to the reinsurer as one time upfront fee. This upfront fee further reduced the already low premium income. In ART, the caps for number of mobile phones and recoverable loss were kept at 50 lakh and Rs.482.03 crore respectively. So, the

probable loss, which the company would suffer as per its own estimation under this policy, worked out to Rs.482.03 crore.

The Chairman and Managing Director of NIC in reply to the Ministry mentioned (April 2004) that the Company was facing loss in the default liability policy (Reliance Infocom Limited). He added that the claims might far exceed the premium collected. Since no traditional cover was available in the international market, the Company opted for a non-traditional cover known as ART. Efforts were being made to impress upon RIL for additional premium for ART cover.

The lapses in the policy are further substantiated by the fact that the concerned Regional Office approached the Head Office for conventional reinsurance protection after experiencing huge flow of claims. The Company, as per guidelines, should have undertaken the risk only after obtaining the conventional reinsurance protection.

Thus, failure on the part of NIC/OIC to extend SCPs on mobile handsets without risk analysis and reinsurance protection resulted in loss of Rs.65.79 crore (including investigation charges) and liability of Rs.118.21 crore on account of pending claims. On the basis of paid/outstanding claims and expenses, NIC and OIC had so far suffered loss of Rs.142.63 crore (NIC Rs.126.58 crore and OIC Rs.16.05 crore) and made GIC suffer loss amounting to Rs.41.37 crore.

10.10 Inadequate internal control system

As per IRDA guidelines the Company was required to formulate the procedure and norms with regard to underwriting and policy issue for the pricing of new products, claims processing and settlement. The Financial Advisor of NIC observed (September 2004) that the system of internal control existing in the Company was ineffective and inadequate and needed to be strengthened.

In reply NIC while admitting the facts and accepting the deficiencies as pointed out in Audit stated (March 2005) that the new default liability cover of RIL was perceived by them as an opportunity to get into the big account of Reliance Group. The Management agreed with all the recommendations made by audit and assured that the authority to issue SCP, Tailor made policy and long term policy would be centralised at Headquarters to safeguard the interest of the Company.

10.11 Conclusion

While underwriting the non-conventional policies, which had serious financial implications, the operating offices did not exercise due diligence and caution and did not ensure the compliance of guidelines issued by IRDA, GIPSA and H.O of NIC/OIC which resulted in huge loss amounting to Rs.142.63 crore (NIC Rs.126.58 crore and OIC Rs.16.05 crore) and made GIC suffer loss amounting to Rs.41.37 crore. No responsibility has been fixed for the Regional/Divisional Offices having exceeded their powers and exposing the Companies to such heavy risk and loss.

10.12 Recommendations

(a) There is urgent need to ensure that all the instructions issued by IRDA, GIPSA and Head Office are complied with by all the operating offices through better Management Information System.

(b) The terms and conditions of the insurance policies for the new products should be formulated by incorporating suitable clauses for premium loading and for periodical review of policy so as to ensure that rating of the policy does not become unviable.

(c) The internal control system needs to be strengthened in order to ensure that the recurrence of such cases is avoided.

(d) The matter needs to be investigated thoroughly and appropriate departmental and legal action taken.

The para was issued to Ministry in December 2004; its reply was awaited (March 2005).

MINISTRY OF HEAVY INDUSTRY AND PUBLIC ENTERPRISES

CHAPTER XI

HMT Limited

Mid term Review on Turnaround Plan

Highlights

The Company entered into a Memorandum of Understanding (MOU) with Government of India (GOI) in August 2000 for the implementation of the Turnaround Plan. In the MOU, GOI agreed to provide 'One time, Last time' support to the Company and in return the Company unequivocally undertook to seek no further financial support.

(Paras 11.1.1 and 11.1.2)

Tractor business has been retained with HMT Limited (Company) though HMT Tractors Limited (Subsidiary) was incorporated in November 1999. The Company decided (November 2003) to close the Subsidiary.

(Para 11.3.1)

Disinvestment in subsidiaries as envisaged in the Turnaround Plan has not been achieved.

(Para 11.4.1)

Contrary to the decision taken in the Turnaround Plan to close unviable units, Food Processing Machinery Plant, Aurangabad is being operated despite incurring huge losses.

(Para 11.5.1)

In the context of continuous steep decline in demand for mechanical watches, the decision in the Turnaround Plan to (i) revive Ranibagh Watch Division and (ii) convert unviable Watch Factory, Srinagar into a separate subsidiary and implement revival plan was not judicious.

(Paras 11.5.3 and 11.5.4)

The projections in the Turnaround Plan were overly optimistic and were not supported by actual trends preceding the period covered in the Turnaround Plan and concrete action plan to achieve them.

(Para 11.6.1)

An unwritten objective of the entire subsidiarisation process was to avoid a reference to the BIFR.

(Para 11.6.4)

Though GOI agreed that the Turnaround Plan projections were no longer valid and the MOU targets for the year 2002-03 and 2003-04 were scaled down to be more realistic, the Company and its subsidiaries could not achieve even the reduced targets.

(Para 11.7.5)

Even though the Company agreed in the MOU not to seek further financial assistance/concessions from GOI, the Company obtained loans, amounting to Rs.190.02 crore till October 2004 for settlement of Voluntary Retirement Scheme payments and Rs.87.38 crore for payment of arrears of salaries and wages of the subsidiaries upto July 2004.

(Para 11.8.4)

The Company could realise revenue of only Rs.58.98 crore through sale of Non-performing assets during the four years ending 31 March 2004 as against the target of Rs.209 crore fixed for the period.

(Para 11.9)

The Ministry has not given due importance to the implementation of the Turnaround Plan in the Company. The posts of important functional Directors of HMT Limited and other Directors of the Subsidiaries were kept vacant during the crucial period of implementation of the TAP.

(Para 11.10)

Various Committees constituted in the Company, either specifically to oversee the implementation of the Turnaround Plan or monitor the performance of the Company in the normal course of business were not effective.

(Para 11.11.2)

11.1 Introduction

11.1.1 HMT Limited (Company) was incorporated in 1953 to produce machine tools and later it diversified its activities into production of watches, lamps, tractors, printing machines, die casting, dairy machinery, presses and press brakes, plastic injection moulding machines, horological machinery, food processing machinery and miniature battery for watches. There was sporadic improvement in the performance of the Company upto 1991-92. The Company, however, started incurring losses since 1992-93 due to new industrial policy which aimed at ushering in a freer economy and welcoming the flow of foreign capital. After taking into account economic and technological changes and the competition emerging in different businesses, the Company contemplated substantial infusion of funds into modernisation and expansion. However, these efforts during the early nineties, did not succeed and the Committee on Public Undertakings (COPU) directed the Company (October 1996) to keep all piece-meal proposals in abeyance and submit an overall revival plan for the approval of the Government. The first comprehensive revival plan was submitted to the Government in June 1998 and the Government of India (GOI) finally approved a Turnaround Plan (TAP) in August 2000. The Company entered into a Memorandum of Understanding (MOU) with GOI in August 2000 for the implementation of the TAP. Meanwhile, its loss increased more than tenfold from Rs.23.94 crore during 1997-98 (before submission of revival plan) to Rs.296.91 crore during 1999-2000 and the accumulated losses went up to Rs.436.51 crore in 1999-2000 and its net worth turned negative.

11.1.2 In the MOU, GOI agreed to provide 'One time, Last time' support to the Company and in return the Company unequivocally undertook not to seek further financial support. The MOU broadly envisaged (i) conversion of Machine Tools,

Watches and Tractor Business groups into subsidiaries for eventual disinvestment, (ii) closure of five unviable units, (iii) revival of 10 units, (iv) Voluntary Retirement Scheme (VRS) to reduce surplus manpower (v) GOI guarantee to raise bonds for making VRS payments and to meet working capital requirements (vi) conversion of loan into equity and waiver of interest thereon and (vii) infusion of funds in the form of equity from GOI to settle statutory dues and dues to financial institutions. These measures envisaged in TAP were to be implemented during the period 2000-01 to 2004-05. A scheme of arrangement (Scheme) was approved by GOI (March 2001) envisaging transfer of assets and liabilities of the Company to its newly formed subsidiaries.

11.2 Scope

The projections made in the TAP, its implementation as per MOU signed with the GOI and actual performance of the Company and its newly formed subsidiaries during the years 2000-01 to 2003-04 were reviewed in Audit and resultant observations are included in succeeding paragraphs.

11.3 Conversion of Business Groups into subsidiaries

11.3.1 As envisaged in the TAP, Machine Tool and Watch Business groups and Tractor Division were converted into four subsidiaries viz. HMT Machine Tools Limited (August 1999), HMT Watches Limited (August 1999), HMT Chinar Watches Limited (May 2001) and HMT Tractors Limited (November 1999). As specified in the Scheme, the Company transferred the assets and liabilities of the units of Machine Tool and Watch Business groups to the concerned subsidiaries effective from 1 April 2000. However, the Company did not transfer Tractor business to HMT Tractors Limited as per the Scheme and applied for closure (November 2003) of the subsidiary (HMT Tractors Limited), being a non-functioning company.

The Management stated (July 2004) that in view of the delay in the disinvestment process, this subsidiary remained defunct and to avoid additional investment without any consequential benefits it was decided to close the subsidiary.

11.3.2 Under the Scheme, certain lands and buildings of the Company located at Bangalore were allocated to HMT Machine Tools Limited and HMT Watches Limited. Their value was appearing in the books of these subsidiaries. The sale of some of these assets yielded profit of Rs.15.41 crore and Rs.37.12 crore during the years 2002-03 and 2003-04 respectively which was retained by the Company in its books instead of transferring the same to the subsidiaries, which was a clear violation of the Scheme.

The Management stated (July 2004) that it was a considered decision to record the profits and cash flow from such disposal in the books of the Company to meet the pressing commitments on account of overdue liabilities and to retain the profitability of the Company. The action of the Company vitiated the financial performance of the subsidiaries as they were deprived of funds required for their operations.

11.4 Disinvestment

11.4.1 As per the TAP, the Company was to disinvest upto 74 per cent of its equity in all its new subsidiaries, generating a profit of Rs.180 crore during the year 2001-02. In

addition, Computer Numerical Control (CNC) Systems Division, the profit making division under HMT Machine Tools Limited, was to be hived off and Rs.50 crore was projected as income during the year 2001-02. The sale proceeds from disinvestment were to be used for liquidating bonds issued for working capital requirement, VRS, upgradation of technology and capital availability. Expressions of Interest (EOI) were invited (July 2002) from interested parties for all subsidiaries except HMT Tractors Limited. No EOI was received for HMT Machine Tools Limited. EOIs received (August 2002) in respect of other two companies, viz., HMT Watches Limited and HMT Chinar Watches Limited were vetted and forwarded to the Ministry for clearance during April 2003. The valuer appointed (April 2004) for valuation of assets of HMT Watches Limited submitted a report on valuation for disinvestment purposes in June 2004. Action to hive-off CNC Systems Division was yet to be taken (July 2004).

11.4.2 The Management stated (July 2004) that the delay in disinvestment could not be attributed to the Company as the action taken by Company regarding the disinvestment was as per the directives of the Inter-Ministerial Group appointed by the Government. They further stated that efforts initiated for locating joint venture partner for CNC Systems Division were not successful. It added (November 2004) that there was no further progress in disinvestment and a policy decision was awaited from the Government.

The fact, however, remains that delay in disinvestment of the subsidiaries and CNC Division deprived the Company of profits as envisaged under the TAP.

11.5 Closure of unviable units/ Revival of loss making units

11.5.1 The TAP envisaged closure of five unviable units viz., Central Metal Forming Institute, Watch Case Unit, Lamp Factory, all in Hyderabad, Food Processing Machinery Unit (FPA) at Aurangabad and Miniature Battery Unit at Guwahati. Except FPA, all unviable units were closed by December 2000. The Company did not close FPA and instead proposed to manufacture automotive gears for tractors in the plant, which did not come through due to financial constraints. FPA had been incurring losses continuously for 11 years and its cumulative loss was Rs.7.86 crore (August 2000). The key factors affecting FPA's performance were low level of product technology and saturation of dairy industry particularly in the co-operative sector. The reason for sudden change in the stand of the Company to revive FPA, which had been chronically running under losses for more than a decade, was not on record.

The Management stated (December 2003) that the issue of closure of FPA had been pending with the Deputy Labour Commissioner, Aurangabad and FPA generated revenue to meet salary requirement of around 88 employees. However, the fact remains that even the TAP had concluded that existence of FPA as a separate unit was not feasible and its closure was approved. FPA continued to incur losses during 2000-01 to 2003-04 also and the accumulated loss rose to Rs.12.99 crore as on 31 March 2004.

11.5.2 Further, UTI Bank Limited, which was appointed (December 2003) to identify failure/shortcoming in the implementation of the TAP and to suggest corrective action, was also entrusted with the specific task of examining the viability of FPA afresh. The report submitted (May 2004) did not contain any recommendations on FPA.

11.5.3 Watch Factory, Srinagar, manufacturing only mechanical watches, was a 'loss making unit but capable of revival' as per the TAP. Its accumulated loss as on 31 March 1999 was Rs.82.53 crore. During 1999-2000, a further loss of Rs.15.57 crore was incurred. In view of the declining trend of demand for mechanical watches and surplus capacity at Bangalore unit, the decision in the TAP to revive and convert the unviable Watch Factory, Srinagar into a separate subsidiary viz. HMT Chinar Watches Limited and to implement revival plan was injudicious. The loss of Rs.52.96 crore incurred during 2000-01 to 2003-04, despite receipt of grant of Rs.34.13 crore from GOI to meet actual cost of wages and salary was, thus, avoidable.

The Management has not offered (July 2004) any remarks on the audit point.

11.5.4 As per the TAP, Bangalore and Ranibagh units, manufacturing mechanical watches, were also proposed to be revived. The installed capacity for manufacture at Bangalore and Ranibagh was 15 lakh and 20 lakh watches per annum respectively. The demand for mechanical watches in India has been showing sharp decline in view of customers' preference for technologically improved and reasonably priced quartz watches. The demand came down to 12.59 lakh watches in 1999-2000 out of which the Company's share was 70 per cent. This further declined to 1.30 lakh during 2003-04, almost wholly contributed by sale of HMT watches. The Company could have met the demand from Bangalore unit itself and in view of the declining demand, could have closed the Ranibagh unit. Therefore, the decision in the TAP to persist with Ranibagh unit was not judicious and further losses to the tune of Rs.105.28 crore incurred during 2000-01 to 2003-04 were avoidable.

The Management has not offered (July 2004) any remarks on the audit point.

11.6 Projections in the Turnaround Plan

11.6.1 The projections in the TAP were mainly based on the anticipated turnaround in economy, general improvement in sentiment for investment, increased plan outlay for Defence, Agriculture and allied activities in the Union Budget for 1999-2000 and the opportunities envisaged in the expansion proposals/ additional investment outlay of some major customers like Bajaj Auto, TVS Suzuki, Punjab Tractors, Railways etc. The projections in the TAP were overly optimistic and were not supported by actual trends preceding the period covered in the TAP and concrete action plan to achieve them.

The Management accepted (July 2004) that the TAP, among other things, had not addressed the effect of economic liberalisation measures of the Government of India and contingencies of likely changes in business environment.

11.6.2 The Company's own projections for sales in July 1998 and February 1999 for the year 1999-2000 were Rs.1316.40 crore and Rs.1158.60 crore, respectively. However, actual sales which were Rs.956.79 crore in 1996-97, came down to Rs.752.38 crore in 1999-2000 and further reduced to Rs.384.46 crore in 2003-04. All three business groups showed declining trend during the same period. Actual sales of machine tools, tractors and watches which were Rs.331.29 crore, Rs.408.82 crore and Rs.193.40 crore in 1996-97 respectively, came down to Rs.262.73 crore, Rs.386.39 crore and Rs.92.94 crore in 1999-2000 respectively. There was a steep decline in domestic sales of mechanical

watches from 22.87 lakh in 1998-99 to 12.59 lakh in 1999-2000 in which the Company had 70 per cent market share. Despite these declining trends, the Company did not revise its projections for 2000-01 and onwards, based on actuals of 1999-2000.

11.6.3 Evidently, the sales projections of Rs.1001.51 crore for 2000-01, with projected increase to Rs.1515.41 crore in 2004-05, and resultant contributions and Profit before tax (PBT) in the TAP were not realistic and should not have been taken as the basis for approval of the TAP in August 2000 for implementation.

The Management stated (July 2004) that the projections in the TAP were arrived at after taking into account the market conditions prevailing at that time and projections were vetted by M/s. A. F. Ferguson (consultants). The reply of the Management contradicts its own statement (refer para 11.6.1) that the TAP did not consider the effect of economic liberalisation measures of the Government on the operations of the Company and the contingencies of likely changes in business environment. Further, the reply is not tenable as the projections of the consultant were subject to the following:

(i) The Company would need to invest and increase its ability to meet demands for improved technology in machine tools.

(ii) The actual performance in tractors would need to be linked to the agricultural sector and aggressive marketing and extensive service support would have to be undertaken.

(iii) The Company was to be able to meet the sales projections for watches, based on inputs of much needed working capital. The other key inputs required to achieve the projection were aggressive marketing and brand building.

However, the Company did not take any action to address the above issues.

11.6.4 Further, the TAP mainly focused on closure of unviable units, subsidiarisation of business groups, assistance from GOI towards equity, waiver of loans etc. The immediate aim of the TAP was to ensure that the Company was kept out of the purview of Board for Industrial and Financial Reconstruction (BIFR) by financial restructuring with assistance from GOI. A similar view was expressed (April 1999) by the Controller General of Accounts (CGA) (Ministry of Finance) in an appraisal of the TAP that the unwritten objective of the entire subsidiarisation process was to avoid a reference to the BIFR, which would have the effect of damaging the brand equity of HMT and render its business prospects even more difficult.

The Management stated (July 2004) that the reasons for the TAP were primarily to give focus and disinvest the individual business groups of HMT viz., Machine Tools, Watches and Tractors. The Management's reply underscores the fact that the focus of the TAP mainly was to restructure the business and not to turnaround the fortunes of the Company. Even the stated primary objective of the TAP was not achieved as the subsidiarisation of Tractors Division did not happen and disinvestment in other subsidiaries did not materialise.

11.7 Performance of subsidiaries

11.7.1 The targets vis a vis achievements in respect of Tractor Business Group for the years 2000-01 to 2003-04 were as under :

Details	2000-01		2001-02		2002-03		2003-04	
	Target under TAP	**Actual**	**Target under TAP**	**Actual**	**Target under TAP**	**Actual**	**Target under TAP**	**Actual**
Sales (Rs. in crore)	474.76	341.63	534.50	284.61	603.81	181.86	690.23	154.22
Profit (Rs. in crore)	45.21	5.28	196.22	1.85	29.25	(43.71)	27.09	(51.09)

	Target as per one time MOU with subsidiaries	**2000-01**	**2001-02**	**2002-03**	**2003-04**
Sundry Debtors (in days of sales)	90	185	254	318	237
Stock of raw material (in days of consumption)	40	71	45	88	90
Work-in-progress (in days of production)	10	26	25	36	37
Stock of finished goods (in days of production)	5	34	22	20	25

Though the industry's sales came down during 2001-02 and 2002-03 by 17 per cent, the Company's sales came down drastically by 35 per cent and the Company's market share declined from 5.36 per cent to 4.20 per cent. Sundry debtors which were 52.47 per cent of sales as on 31 March 2001 increased to 84.28 per cent as on 31 March 2004. This resulted in working capital crunch. Further the Company's material procurements were high and it could not convert its work in progress into finished goods within a reasonable period. The stock held by the Company was also above the targeted level. The Company received (December 2003) Rs.two crore as equity and Rs.two crore as loan (at the rate of 12.50 per cent) from the GOI towards budgetary support for capital expenditure.

The Management stated (July 2004) that sundry debtors appeared to be high in terms of percentage due to reduction in turnover. The decline in production and sales was mainly due to sluggish market demand, quality problems and unsuitable product portfolio for wet farming. The Management further stated that the inventory should be viewed considering the number of bought-outs, assembly operations in three different locations, geographically dispersed stockyards and widespread dealer network. The reply is not tenable as the decline in the performance was mainly due to non-introduction of new models of tractors as per market need and non-modernisation of the facilities. This is

evident from the fact that during 1998-2003 even though industry's sales came down by 36 per cent, the Company's sales came down by 64 per cent. Decline in acceptability of Company's products due to imported products launched by the competitors also contributed to the poor performance.

The Committee appointed by the Ministry (August 2000) to inquire into diversion of funds meant for payment of statutory dues of the employees for other purposes and setback in the performance of the Company during 1999-2000, observed (November 2000), that the position of sundry debtors of the Tractor Business Group was alarming and almost half of the sales had not been realised during 1999-2000. The increase in sundry debtors was largely contributed by pushing the finished stock inventory to the dealers to show higher sales. The Tractor Business Group let debtors and inventories pile up leading to cash crunch. Necessary capital expenditure for modernisation/ expansion/quality improvements did not take place due to the diversion of funds of Rs.4.96 core in 2000-01 to the Watch Group. Despite the indictment by the Committee, there was no improvement. On the contrary, there was further deterioration in the position of sundry debtors.

The Management stated (July 2004) that the inventory with dealers increased due to advance selling of tractors and higher dealer credit. Also no efforts were made for capital investment due to uncertainty of business in view of disinvestment. The reply of the Management is not tenable as the Company continued the practice of dumping of tractors with dealers, which was fraught with risk in recovery. Though the Company took up expansion of Tractor Assembly at Hyderabad, after investing (July 1999 – July 2000) Rs.98.84 lakh, the work was abandoned in March 2001 in view of low production levels and cash crunch rendering the expenditure infructuous.

11.7.2 The targets vis-a-vis achievements in respect of HMT Machine Tools Limited for the years 2000-01 to 2003-04 were as under:

Details	2000-01		2001-02		2002-03		2003-04	
	Target under TAP	**Actual**	**Target under TAP**	**Actual**	**Target under TAP**	**Actual**	**Target under TAP**	**Actual**
Sales (Rs. in crore)	300.00	209.28	320.00	260.98	340.00	229.38	365.00	198.21
Profit (Rs. in crore)	(9.93)	(96.17)	56.32	(70.65)	8.50	(102.17)	9.69	(119.08)

	Target as per one time MOU with subsidiaries	**2000-01**	**2001-02**	**2002-03**	**2003-04**
Sundry Debtors (in days of sales)	96	102	127	120	123

Stock of raw material (in days of consumption)	96	186	166	191	173
Work-in-progress (in days of production)	78	112	89	88	90
Stock of finished goods (in days of production)	74	111	81	64	66

The subsidiary could not achieve most of the targets fixed under the TAP. The Committee appointed (August 2000) by the Ministry observed (November 2000) that the losses were due to low productivity, technological obsolescence and quality problems. The consultant who vetted the projections in the TAP observed that the subsidiary was expected to achieve the sales projections by investments to enhance its ability to meet demands for improved technology in machine tools. Though the TAP had projected capital expenditure of Rs.37.10 crore (Rs.12.10 crore out of budgetary support and balance of Rs.25 crore to be met out of internal resources) during the years 2000-01 to 2003-04. The subsidiary could get Rs.4.20 crore only as budgetary support.

The Management accepted (July 2004) that internal resource generation was inadequate and as such the capital expenditure as envisaged in the TAP could not be put through.

11.7.3 The targets vis a vis achievements in respect of HMT Watches Limited for the years 2000-01 to 2003-04 were as under:

Details	2000-01		2001-02		2002-03		2003-04	
	Target under TAP	**Actual**	**Target under TAP**	**Actual**	**Target under TAP**	**Actual**	**Target under TAP**	**Actual**
Sales (Rs. in crore)	220	108.64	247.50	80.57	275.00	45.35	302.50	26.92
Profit (Rs. in crore)	(14.15)	(59.18)	1.74	(106.29)	49.82	(112.92)	18.20	(134.81)

	Target as per one time MOU with subsidiaries	**2000-01**	**2001-02**	**2002-03**	**2003-04**
Sundry Debtors (in days of sales)	60	229	304	392	635
Stock of raw	90	266	446	1076	993

material (in days of consumption)					
Work-in-progress (in days of production)	45	95	139	253	288
Stock of finished goods (in days of production)	60	188	231	356	480

The subsidiary could not achieve any of the targets fixed in the TAP. Its turnover decreased and loss increased year after year. While reacting to the revised Road Map submitted by the subsidiary (March 2003), the Ministry accepted (August 2003) that the TAP had failed to produce any improvement in the working of the subsidiary. It also observed that since its inception the proposals appeared to be ad-hoc in nature and requested the Company to undertake a quick study to ascertain the reasons for the poor performance of the TAP and take quick corrective action. The committee constituted in this connection observed (December 2003) that major factors contributing to the poor performance were (i) overambitious projections, (ii) cash losses suffered prior to the TAP, (iii) inadequate working capital for operational purposes, (iv) outsourcing of complete watches and components leaving the inhouse capacity idle, (v) non-availability of marketable watches, (vi) lack of professional marketing; and (vii) existence of spurious HMT Watches.

The Company wanted (February 2002) a mid-course correction for the targets set for (i) Machine Tools, due to the drastic change in the macro business environment, (ii) Tractors, due to negative growth of the industry since 2000-01 resulting in lower levels of production, consequent loss from operations and liquidity crunch and (iii) Watches, due to cumulative losses, and unbridged gap of working capital leading to unsustainable operations.

11.7.4 The targets vis a vis achievements in respect of HMT Chinar Watches Limited for the years 2000-01 to 2003-04 were as under:

(Rs.in crore)

	2000-01		**2001-02**		**2002-03**		**2003-04**	
	Target as per TAP	**Actuals**	**Target as per TAP**	**Actuals**	**Target as per TAP**	**Actuals**	**Target as per TAP**	**Actuals**
Sales	6.75	1.94	9.00	2.02	11.25	1.21	13.50	1.32
Profit	(3.90)	(7.95)	(4.01)	(10.16)	(4.42)	(6.31)	(14.77)	(28.54)

It could be seen from the above that though the annual sales ranged between Rs.1.21 crore and Rs.2.02 crore, the losses ranged between Rs.6.31 crore and Rs.28.54 crore per annum.

11.7.5 The Ad hoc Task Force formed under the Ministry to discuss the MOU, observed (February 2002) that the Company should have a mechanism to forecast future challenges

and amend business plans in time to be profitable. As it was agreed that the TAP projections were no longer valid, the MOU targets were scaled down for the years 2002-03. Even the proposed targets in the draft MOU for 2003-04 pending for approval were also scaled down. The table below indicates the targets as per the TAP, reduced targets as per MOU with GOI and actual achievements in respect of subsidiaries and Tractor Business Group for the years 2002-03 and 2003-04.

(Rs. in crore)

		MTL[♣]		HWL[♦]		TBG[♥]		CWL[♠]	
	Year	**Sales**	**PBT**	**Sales**	**PBT**	**Sales**	**PBT**	**Sales**	**PBT**
Target as per TAP	2002-03	340	9	275	50	604	29	11	(4)
	2003-04	365	10	303	18	690	27	14	(15)
Target as per MOU	2002-03	289	(7)	234	37	440	(3)	9	(5)
	2003-04	300	(32)	200	2	348	4	9	21
Actual	2002-03	229	(102)	45	(113)	182	(44)	1	(6)
	2003-04	198	(119)	27	(135)	154	(51)	1	(29)

It would be seen from the above that even the revised MOU targets were not achieved. Thus, the projections in the TAP were overly optimistic and un-achievable and the Company had not been able to set for itself achievable targets.

11.8. Financial Restructuring

11.8.1 An important aspect of financial restructuring was to reduce annual interest outgo by restructuring of debt through additional equity from GOI, sale of assets and concessions from creditors.

11.8.2 The Company received (September 2000) Rs.250 crore from GOI in the form of contribution towards equity capital to settle statutory dues and borrowings which it utilised for the settlement of statutory dues (Rs.114.91 crore), dues of financial institutions (Rs.53.51 crore), repayment of debentures (Rs.42.53 crore) and retirement of high interest bearing bonds/ borrowings (Rs.39.05 crore). The Company obtained financial benefit to the tune of Rs.20.23 crore in the course of settlement of dues of financial institutions/retirement of high cost debts/ borrowings by way of waiver of interest. In addition, the Company also received (2000-2001) Rs.10.05 crore as equity capital for meeting capital expenditure; GOI loan of Rs.39.70 crore was converted into equity and Rs.12.74 crore of interest accrued waived. GOI further extended the guarantee on Bonds raised for Rs.40.43 crore to meet working capital requirements of the Watch subsidiary.

[♣] *HMT Machine Tools Limited*

[♦] *HMT Watches Limited*

[♥] *Tractors Business Group*

[♠] *HMT Chinar Watches Limited*

11.8.3 The above measures resulted in turning the Company's negative net-worth into positive and saving in interest cost on loans repaid/ converted into equity. The Company continued to carry high interest bearing loan of Rs.204.64 crore and cash credit loan of Rs.175.25 crore as on 31 March 2000. However, the Company's positive net-worth of Rs.54.14 crore in 2000-01 came down to Rs.11.16 crore in 2003-04 and net-worth of other newly formed subsidiaries turned negative in the very first year of their operation.

11.8.4 The financial restructuring envisaged under the TAP to turn the declining performance of the Company around was not achievable as discussed below:

(i) The Company was already burdened with annual interest charges on various bonds/loans ranging from Rs.80 to Rs.90 crore prior to 2000-01 and it further increased due to annual interest payments of more than Rs.20 crore towards VRS Bonds.

(ii) The Company required Rs.470 crore to retire 6947 employees under VRS. GOI did not give grant-in-aid to meet VRS related payments and agreed only to guarantee bonds issued to finance VRS payments and 50 per cent interest subsidy thereon. The Company received Rs.72.11 crore towards interest subsidy and Rs.14.40 crore towards subsidy for guarantee fee on bonds during the years 2000-01 to 2003-04. The projected Profit before tax also did not take into account Rs.470 crore to be paid towards regular retirement benefits and VRS compensation. This further reduced its operational performance and profitability as it had incurred Rs.22.39 crore in 2001-02 towards VRS related expenditure which further increased to Rs.54.37 crore in 2003-04 due to additional VRS given to 2204 employees. The Company had been requesting GOI for 100 per cent interest subsidy since November 2001 which had not been provided by GOI (July 2004).

(iii) Though prime lending rate was falling rapidly, the Company and its subsidiaries were raising funds through borrowings at a cash credit rate of 15.50 per cent. ICRA* (Credit Rating Agency) determined (March 2002) the Company's credit rating as 'inadequate safety and timely payment of principal and interest not guaranteed'. Therefore, the Company's efforts to raise Rs.300 crore from the market against the securitisation of non-performing assets did not succeed (December 2003) and it ended up taking a loan of Rs.190.02 crore from the Government at 15.50 per cent per annum (October 2004). The interest liability of the Company prior to restructuring was Rs.94.35 crore in 1999-2000, whereas the interest liability subsequent to restructuring of the Company and its subsidiaries increased to Rs.163.20 crore in 2003-04. Though there was sharp decline in prime lending rate coupled with decrease in turnover from Rs.752.38 crore in 1999-2000 to Rs.384.46 crore in 2003-04, the interest on cash credit which was Rs.32.19 crore decreased only to Rs.29.81 crore during the same period.

(iv) As the Company failed to provide funds for repayment of the bonds (Rs.40.40 crore) with interest amounting to Rs.43.43 crore due in November 2003, UCO

* *Investment Information Credit Rating Agency*

Bank, the Trustee to the Bond issue requested (October 2003) GOI to honour the Guarantee. The Company, with the approval of GOI, obtained (January 2004) a short-term loan of Rs.56.23 crore from Bharat Heavy Electricals Limited, *inter alia* to meet the commitment to the UCO Bank. The short-term loan was subsequently repaid (March/September 2004) out of another loan from UCO Bank.

(v) Even though the Company had agreed in the MOU not to seek further financial assistance/concessions from GOI, the Company obtained loans amounting to Rs.190.02 crore at 15.50 per cent interest from GOI upto October 2004 for settlement of VRS payments. The Company subsequently requested the Government to convert the loan into equity. The decision of GOI was awaited (July 2004). In addition the Company availed of (March/October 2004) GOI loan of Rs.87.38 crore at 15.50 per cent interest for payment of arrears of salaries and wages for subsidiaries and statutory dues for the period upto July 2004. The Company also obtained (September 2004) GOI Guarantee for raising a loan of Rs.300 crore (at the rate of 6.75 per cent) for retiring high cost debts and availed loan of Rs.59.56 crore till October 2004. Thus, the Company was not able to generate own funds to come out of the debt trap.

The Management stated (July 2004) that the subsidiaries were struggling to achieve the projected turnover without any operating resources in the form of working capital and for further reduction of surplus manpower had to necessarily approach GOI for financial assistance to implement VRS. The reply confirms that the Company could not achieve the underlying objective of financial restructuring viz., reduced annual interest outgo, resulting in improved availability of funds for operations. On the contrary, the subsidiaries were not able to pay even salaries and wages, necessitating further GOI loan.

(vi) The TAP had envisaged financing of projected capital expenditure of Rs.62.86 crore from internal resources to be generated during 2000-01 to 2003-04, which was not realistic due to the fact that the Company could not generate funds from internal resources from 1993-94 onwards and internal resources generated were negative to the extent of Rs.281.84 crore (1999-2000). Out of Rs.15.10 crore envisaged as capital expenditure for the year 2000-01 as part of the TAP, only Rs.7.20 crore was released by the GOI and the balance Rs.7.90 crore was not released due to non-furnishing of 'Utilisation Certificates' for the earlier receipts.

(vii) Thus, the endeavours of the TAP to turn the performance of the Company around did not help in improving the performance and even in arresting the declining performance. While appraising the projections of the TAP, the CGA stated (April 1999) that infusion of GOI equity would be used for discharging liabilities with no asset creation or improvement in the business prospects and it would not result in reviving the Company. The apprehension of CGA was evidently confirmed.

The Management accepted (July 2004) that the funds infused by GOI were utilised for repayment of debts only and did not result in the availability of sufficient funds for

working capital. The interest component and write-off of VRS compensation affected the bottomline of the Company. The changed business environment coupled with negative bottomline affected the Company's plans to tap funds from the market.

(viii) As the Company had not been able to service the debts, despite financial restructuring under the TAP, UTI Bank Limited (December 2003) was appointed to conduct a detailed review of implementation of the TAP to identify failures/ shortcomings, suggest corrective action along with the formulation of a financial model to determine the financial viability and to carry out further financial restructuring of the Company and its three new subsidiaries. The decision of the Management to attempt further financial restructuring is a tacit admission of the fact that the financial restructuring under the TAP failed to improve the performance and financial health of the Company and its subsidiaries.

The report submitted by UTI Bank Limited, (May 2004) suggested (i) further financial restructuring by conversion of GOI loans (Rs.192 crore availed in 2003-04) into equity, 100 per cent subsidy on VRS bonds and GOI guarantee for funds to meet working capital (Rs.200 crore), to pay statutory dues (Rs.125 crore) and debts (Rs.300 crore); (ii) infusion of Rs.400 crore by GOI by way of grants immediately to rescue the Company from debt trap; (iii) physical restructuring by reduction of manpower with GOI funds, consolidation of facilities in subsidiaries, outsourcing, revamping of marketing and receivables management and disinvestment of watches and tractors business.

The increased financial aid from GOI proposed by UTI Bank Limited, to salvage the Company is indicative of the further deterioration in the financial health during the period of implementation of the TAP. The Company has prepared a revival /restructuring plan for the Company, HMT Machine Tools Limited and HMT Watches Limited (September 2004) which has been entrusted (October 2004) to the consultants for vetting.

11.9 Disposal of Non- Performing Assets

The TAP envisaged mobilisation of funds by selling Non-Performing Assets (NPA). The Company identified surplus land and buildings valued at Rs.912.70 crore for sale as NPA (Rs.337 crore from property in Bangalore and Rs.575.70 crore in the rest of India). However, as per the TAP, land and buildings valued at Rs.218 crore only were to be disposed of during 2000-01 to 2004-05. The Company realised only Rs.57.59 crore and Rs 1.39 crore from sale of land within Bangalore and outside Bangalore respectively by 2003-04, which was 28 per cent of the target of Rs.209 crore fixed for the period upto March 2004.

The Management stated (December 2003) that shortfall in sale of NPA was due to exceptionally low demand in the market and that even the property consultants appointed could not increase the sales. The delay in disposal of NPA had a very serious implication for the Company and its subsidiaries as in the absence of funds from sale of these assets, the Company failed to liquidate high-cost debts and enhance availability of funds to finance its production activities and capital expenditure.

11.10 Role of Ministry in the implementation of the TAP

As per the TAP, the overall responsibility and accountability for the implementation of the TAP rested with Chairman and Managing Director of the Company who was to be assisted by the functional Directors during the currency of the TAP after formation of the new companies as envisaged in the TAP. However, important posts of Directors were abolished or kept vacant during the crucial period of implementation of the TAP as indicated below:

(i) The post of Director (Finance) of the HMT Limited was kept vacant since November 2000 and was abolished in September 2001.

(ii) The post of Director (Personnel) which was re-designated as Director (Tractors) in September 2001 was kept vacant since July 2002 and subsequently held as additional charge by the Chairman and Managing Director.

(iii) The post of Director (Marketing Policy, Corporate Planning and Projects) was re-designated (September 2001) as Director (Organisation and Management). The post was vacant since January 2003 and held as additional charge by the Chairman and Managing Director.

(iv) Even though posts of Director (Finance), Director (Technical), Director (Marketing) and Director (Human Resources) were created (September 2001) for the subsidiaries viz., HMT Machine Tools Limited and HMT Watches Limited, these posts were not filled (July 2004).

(v) The post of Managing Director of HMT Machine Tools Limited, vacant since June 2003, was filled up in May 2004. As the Managing Director of HMT Watches Limited was under suspension from 30 July 2003, the Group General Manager, Watch operations, was entrusted with that charge on ad-hoc basis by GOI. As the suspension order was set aside, the Managing Director resumed charge in May 2004.

The Management stated (July 2004) that (i) posts of functional Directors were not filled up at the instance of GOI due to the poor performance of its subsidiaries, (ii) Director (Tractors) in HMT Limited had been renamed Director (Finance) and the process of filling up of the Directors' posts had been initiated by PESB♠. No positive action had, thus, been taken by the Ministry in this regard to set the tone for better performance.

11.11 Role of Management in implementation of the TAP

11.11.1 The Committee appointed by the Ministry observed (November 2000) that (i) the Unit Chiefs/ Business Group Chief of Machine Tools Limited could have definitely made more efforts for arresting the decline, (ii) the entire Watch Business Group had been badly mismanaged financially, commercially and technically; the top management of the Watch Business Group (the unit chiefs and Business Group chief) allowed a drift in the affairs by their inaction and the top Corporate Management also

♠ ***Public Enterprises Selection Board***

failed in rectifying the situation and (iii) the Tractor Business Group Chief let debtors and inventories pile up leading to cash crunch.

11.11.2 Despite the above observations, various Committees constituted by the Company, either specifically to oversee the implementation of the TAP or monitor the performance of the Company in the normal course of business were not effective as indicated below:

(i) A Company level Committee was constituted (December 2000) to monitor the implementation of the TAP. The Committee was to meet once in a week to discuss all matters connected with the implementation of the TAP and devise suitable remedial measures. However, the Committee held only six meetings till January 2001 and no meeting took place thereafter.

(ii) The Executive Committee, at the corporate office of the Company, comprising the Chairman and Managing Director, wholetime Directors and Business Group chiefs/ Subsidiary chiefs was constituted (September 1986) to coordinate the work of the units/Business Groups and was to meet at least once in every two months to review the performance and take appropriate action. However, the Committee held only seven meetings subsequent to the commencement of implementation of the TAP, contrary to the assertion in the Annual Report of the Company that meetings were being held regularly to review the performance of the Company.

(iii) A Unit Board, a governing body at unit level, comprising the head of the unit and heads of Finance, Production, Engineering and Marketing departments of the unit and representatives from unions/officers Association, was constituted in each unit of subsidiary companies. Though time and again instructions were issued that Unit Board meetings should be held regularly once a month or as frequently as possible to formulate implementable actions to mitigate the problems, the meetings were held very sporadically with no emphasis on action plans.

(iv) The Audit Committee of the Board of Directors formed under Section 292A of the Companies Act 1956, was non-functional in HMT Limited in all the years for want of quorum. Even though it met twice in the case of HMT Machine Tools Limited and twice in the case of HMT Watches Limited during the years 2002 to 2004, it did not discuss any matter connected with the TAP.

The Management did not furnish any reply to the above observations.

11.12 Conclusions

(i) The TAP failed to turn the fortunes of the Company and its subsidiaries around due to (i) overly optimistic projection not supported by actual trends in the period preceding it, (ii) lack of plan/strategies for product diversifications, development, technology upgradation and business plans to convert loss- making units into profit making ones, (iii) failure to consider the effects of economic liberalisation measures of GOI and contingencies of likely changes in business environment, (iv) failure on the part of the Ministry/Management to consider the apprehensions (April 1999) of CGA with regard to fine tuning the projections

(ii) The unwritten objective of the TAP was to restructure the Company and avoid a reference to the BIFR and not to turn its and its subsidiaries' fortunes around.

(iii) The networth of the Company came down substantially and the networth of all the three subsidiaries turned negative.

(iv) Half-way through the implementation of the TAP, the Ministry conceded that the TAP projections were no longer valid.

(v) The Company failed to achieve the projections in the TAP for disinvestment and the slow process of disinvestment resulted in delay in liquidating bonds issued for working capital requirements, delay in technological upgradation and lack of capital availability.

(vi) The Company failed to close Food Processing Machinery Unit which was unviable as it was continuously incurring losses for more than a decade.

(vii) In view of sharp decline in demand for mechanical watches the decision of the Company to persist with Ranibagh unit and convert unviable Watch Factory, Srinagar into a separate subsidiary and implement revival plan was injudicious.

11.13 Recommendations

In the light of the foregoing, the following recommendations are made:

(a) In view of its standing in the market for over 50 years, the Company should attempt to assess the ground realities and project achievable targets. The Company should develop a mechanism to forecast the future changes and amend its business plans in time to be profitable.

(b) The Company and its newly formed subsidiaries should concentrate on technology upgradation and marketing aspects so as to withstand competition.

(c) Efforts on a war footing are needed to collect debts and dispose of non-moving inventories and non-performing assets to generate funds for investment.

The review was issued to the Ministry in October 2004; its reply was awaited (March 2005).

MINISTRY OF SHIPPING

CHAPTER : XIII

Dredging Corporation of India Limited

Dredge Repairs

Highlights

The Company had spent Rs.374.42 crore towards repair and maintenance of its Dredgers, which constituted 34 per cent of the total operating expenditure.

(Para 12.1)

Delay in dry-docking beyond the prescribed period of 18 months led to decline in dredging production of 35.58 lakh M^3.

(Para 12.3.1)

Delay in obtaining statutory clearances for establishing the sea-worthiness of the vessels led to idling of the dredgers and increased repair time resulting in loss of revenue of Rs.7.12 crore.

(Para 12. 3.3)

Cost overrun compared to the contracted cost ranged from 21 to 91 per cent involving an additional expenditure of Rs.13.13 crore in nine dry-docks.

(Para 12.4.1)

Time over run compared to the agreed time ranged between 17 to 75 days with a variation of 51 to 183 per cent in respect of 17 cases of regular dry-docks. Because of this delay the Company suffered loss of revenue of Rs.14.40 crore in 13 cases after adjusting Rs.9.30 crore recovered towards liquidated damages from the repair firms.

(Para 12.4.2)

The Company lacked ability to prepare cost estimates for dry-dock package in house. It relied on the tariff information obtained from local shipyard at Visakhapatnam though it was in the business for the last 28 years.

(Para 12.4.3)

The Company awarded works to a private yard due to incorrect evaluation in two cases by ignoring PSU shipyards where they were the lowest. In one case the Company cancelled the global tender and sought a fresh quotation on nomination basis. This resulted in loss of revenue of Rs.3.19 crore.

(Para 12. 5)

The work orders contain a security clause against premature failure of repairs within a period of 90 days. However, in no case were these provisions invoked and the Company absorbed the entire repair cost besides sustaining loss of revenue of Rs.6.40 crore in two cases.

(Para 12.6.1)

The Company ought to ensure the exact availability of dry-dock slots before the Dredgers sail to the repair yards to avoid idling, loss of dredging time and loss due to unnecessary voyages. However, the Company allowed vessels to sail without first ascertaining the availability of dry-dock slots resulting in idling of the dredgers, avoidable expenditure on voyage and loss of time and revenue of Rs.1.72 crore in two cases.

(Para 12.6.2)

Although the Company spent Rs.185.13 crore on stores and spares during 1999-00 to 2003-04, it did not have proper inventory control techniques like Vital Essential and Desirable analysis, fast/slow moving items analysis, etc.

(Paras 12.7 & 12.7.1)

The Company without verifying the actual use, continued to dispatch stores and spares to dredgers (on board) resulting in huge accumulation of on board inventory which stood at Rs.77.08 crore as of March 2004.

(Para 12.7.2)

12.1 Introduction

Dredging Corporation of India Limited (the Company) was incorporated in March 1976 as a fully owned Government Company with its Registered Office in New Delhi and Corporate Office at Visakhapatnam. Its authorised capital and paid-up capital as on 31 March 2004 were Rs.30 crore and Rs.28 crore respectively. The Government disinvested (September 1992) 4,02,300 shares of the Company valuing Rs.40.23 lakh. Further disinvestment of 56,00,000 shares was offered to the public during February - March 2004. The shares of the Company are listed in Delhi, Kolkata, Mumbai and National Stock Exchanges.

The Company has been catering to the dredging needs of all major and some minor ports, Indian Navy and shipyards in the country. As of 31 March 2004, the Company had 10 Trailer Suction Hopper Dredgers (TSHD) and two Cutter Suction Dredgers (CSD). The depreciable age of a Dredger is about 14 years. Out of the 12 Dredgers owned by the Company, seven were substantially old and fully depreciated as on 31 March.2004.

Maintenance and repairs of the Dredgers is broadly classified as:

(i) routine maintenance and minor repairs carried out at the work site in afloat condition

(ii) major repairs undertaken at repair yards both in afloat condition and by dry-docking the vessels and

(iii) emergency repairs, depending on the nature of the defect, undertaken immediately both at the work site and at repair yards.

The Company evolved a written manual viz., Company Procedure Manual (CPM) only in July 2001 setting out the procedures to be followed for operation and maintenance of the dredgers. It undertook 38 major repairs including eight cases as emergency repairs during the period 1999-00 to 2003-04. Of these, 19 cases were entrusted on global tender basis, six on limited tender and 13 on nomination basis. The following table gives year-wise details of operational expenditure incurred during the last five years ended 31 March 2004:-

Year	Operational Expenditure						Percentage of Repair expenditure to Total operational expenditure
	Minor Repairs	Major Repairs	Stores & Spares	Total Expenditure on Dredge Repairs	Others incl. wages, fuel cost etc.	Total Operational Expenditure	
	(Rs. in crore)						
1999-00	4.40	23.88	22.68	50.96	98.14	149.10	34
2000-01	3.09	33.87	31.85	68.81	130.48	199.29	35
2001-02	6.80	25.48	33.97	66.25	154.27	220.52	30
2002-03	6.09	30.37	44.89	81.35	177.02	258.37	31
2003-04	4.92	50.39	51.74	107.05	172.48	279.53	38
Total	25.30	163.99	185.13	374.42	732.39	1106.81	34

As may be seen from the above, the Company incurred Rs.374.42 crore towards repair and maintenance of its Dredgers, which constituted 34 per cent of the total operating expenditure.

12.2. Scope of Audit

In order to assess the efficiency and effectiveness of the system, the activity of dredge repairs with reference to dry-dockings during the last five years from 1999-2000 to 2003-04 was reviewed in July 2004.

12.3. Delay in dry-docking

The planning of dry-docking of the dredgers is to be made keeping in view the statutory requirements, need to maintain the vessel in prime condition and loss of revenue during the dry-docking period. As per statutory requirement, ocean going vessels are to be dry-docked twice in five years and the gap between two consecutive dry-docks should not exceed three years. The dredgers have a lot of machinery and work round-the-clock in shallow waters compared to other ocean going vessels, resulting in increased rate of wear and tear. The Company evolved a policy to dry-dock the dredgers once in 18 months. According to the Company's Accounting Policy (from 2000-01) a provision for dry docking expenses is made for every dredger on the assumption that they are dry docked once in 12 months. The Company's technical consultants viz. KPMG, also opined (March 2001) that dredgers should be dry-docked once in one to one and a half years and any slippage would affect the efficiency of the dredging operations. Delays in dry-docking have had adverse impact as brought out in the succeeding paragraphs.

12.3.1 Impact on Production

It is the regular overhauls and repairs during dry-docking that keep the level of efficiency of a dredger at the normal level. Therefore, when a vessel is not dry docked in time, it is likely that its production would deteriorate.

Out of 38 major dry-docks, in the case of 24 (excluding emergency cases and other six cases) the dry-docking should have been done within 18 months from the previous dry-dock. While in 16 cases dry-docks were undertaken within the requisite period, in eight cases, there were delays ranging from three to 17 months. Of these, in six cases, on account of delay, the production was adversely affected. The tabulation below brings out the position.

Dredger	Slippage (months)	Average production (M^3/hour)		Percentage of increase in production	Loss of production (Lakh M^3)
		During slippage period	After dry dock		
XIV	7	566.676	601.247	6	1.28
VIII	14	974.710	1161.092	19	10.77
XII	9	526.606	638.536	21	5.83
XI	10	746.733	969.259	30	8.42
VIII	3	1158.882	1430.331	23	5.29
XI	6	788.827	917.138	16	3.99
Loss of total production due to delay in dry-docking the dredgers on time					35.58

As is evident from the above, there was improvement in the production performance of the dredgers after dry-docking ranging from six to 30 per cent. Had the dry-docks been undertaken within the scheduled 18 months, the production of the Company would have been higher by 35.58 lakh M^3 in the above six cases. This loss in production was a direct consequence of Management's inability to put into effect its own policy regarding dry-docking of dredgers.

The Management replied (July 2004) that

(i) the delay period had to be reckoned with reference to previous dry-docks including emergency dry-docks because during such emergency repairs other defects were also repaired.

(ii) the parameters of output of a dredger were extremely variable as they were dependent upon a number of factors like soil, siltation pattern, littoral flow, etc.

The Management's contention is not tenable as:

(i) even though some normal defects were also attended to during emergency repairs, the audit point is with reference to the Company's own policy of dry docking once every one and a half years.

(ii) the Management, itself agreed that the dry-dockings were undertaken for improving the operational efficiency and

(iii) the conditions of working of dredgers were similar in the two periods i.e. the ports before and after the dry-docks were the same during the slippage period and after dry-dock period in three cases.

12.3.2 Impact on fuel consumption

Expenditure on fuel is one of the major costs in undertaking dredging. The Company incurred Rs.470.14 crore towards fuel during the period of review, which was 42 per cent of total operating expenditure. Periodical dry-docks ensure efficient fuel consumption.

In the course of audit it was observed that on account of delays in dry-docking in two cases, there was excessive consumption of fuel during the slippage period compared to period after dry-dock. The excess fuel consumption was of the order of 788 Kilo litres involving an additional cost of Rs.1.38 crore to the Company, which was avoidable.

12.3.3 Impact of delay in obtaining Statutory clearances

Mercantile Marine Department of Director General of Shipping (MMD), Government of India is the statutory authority which conducts the necessary periodical surveys/inspections of the vessel and issues certificates like Load Line Certificate, Docking Survey, Safety certificates, etc. The Indian Register of Shipping (IRS) also conducts the necessary surveys and advises regarding the repairs to be undertaken. As per the statutory requirements, dredgers are not allowed to operate without valid certificates. Keeping in view the substantial revenue earned by the dredgers per day, it is essential to ensure that all certificates are renewed/revalidated without fail.

However, it was observed in Audit that there were lapses in this regard as discussed below:

(i) The docking survey of Dredge-IX was due by March 1999. Accordingly, the Company planned to dry-dock in April 1999 and also in May 1999. On both the occasions, the Management obtained extension of time for re-validation of certificates and diverted the vessel to commercial operations without dry-docking as planned. Subsequently, when it attempted to dry-dock in May 1999 at Cochin Shipyard Limited (CSL), the latter expressed inability to provide a dry-dock slot. Hindustan Shipyard Limited (HSL) also, when contacted (May 1999), indicated its inability to provide a dry dock slot at that time. As the Director General Shipping refused further extension of time, having no option the Company entrusted the work to Dredge Repair Company of India Limited (DRCIL). DRCIL took 74 days for completion of the work as against the agreed 30 days, which resulted in additional time of 44 days. Thus, due to not undertaking dry-dock when due, the Company was forced to entrust the work to DRCIL and sustained a loss of revenue of Rs.5.15 crore.

(ii) The statutory survey of Dredge- VI was due by June 1998. The Company failed to synchronize the same during emergency dry-docking undertaken in January 1998. During inspection in February 1999, IRS recommended immediate dry-docking. As IRS denied further extension, the Company had to suspend the operations for 16 days before dry-docking the Dredger. Thus, the failure to get the survey synchronized at appropriate time and failure to dry-dock before expiry, resulted in idling of the vessel with consequential loss of revenue of Rs.1.06 crore.

(iii) The statutory survey of Dredge- V was due before July 1999. Though, the dredger was dry-docked previously in July 1998, the statutory surveys were not synchronized. When the dredger was in Haldia during July 1999, it was kept idle for 13 days while the Company was attempting to obtain extension of time from the DG Shipping. Thus, the failure to synchronize the survey during previous dry-dock and failure to seek extension well before the expiry of the validity resulted in idling of the dredger for a substantial period and loss of revenue of Rs.91 lakh.

In respect of (i) above, the Management replied (July 2004) that while the vessel was on its way to Cochin Shipyard for dry docking, it had to be diverted to New Mangalore Port for emergency operations and once Cochin Shipyard expressed non-availability of dry dock it had no option but to dry dock the vessel at DRCIL. Due to the intermittent breakdowns of the infrastructure at the dry-dock and due to taking up of additional works, the work was delayed.

The reply is not tenable as the Company was reacting to situations rather than acting according to schedule for dry-docking.

While furnishing reply to (ii) and (iii) above, the Management agreed (July 2004) that the renewal of certificates had to be kept in view almost 18 months in advance to converge for successful renewal. However, in respect of the cases cited, the Company stated that the instances were five years old. The fact that these were old cases does not detract from the need for corrective action in such cases.

12.4. Estimation of Repair Cost and Time

The Company has an established system for identifying defects for preparing work packages based on which quotations are obtained from the shipyards for dry-docking proposals. Immediately after completion of a dry dock, defects noticed from time to time are recorded for preparation of detailed work package of next dry-dock. However, in certain areas the extent of repairs is known only after opening the dredging machinery during the course of dry-docking. In addition the statutory agencies, on inspection, advise repairs in certain cases. Considering these aspects, all the repair yards are informed that there would be additional scope to the extent of 20 per cent towards unforeseen jobs. Accordingly, approvals are obtained for the quoted cost of the successful bidder plus 20 per cent towards unforeseen jobs.

12.4.1 Cost over-run in repairs

Inaccurate estimates of costs initially place the Company in a disadvantageous situation as the additional quantities have, perforce, to be entrusted at the rates offered by the Yard, which are not necessarily competitive. Further, the Management, while explaining the excess expenditure and time overrun in case of dry docking of a dredger assured the Board of Directors (May 1997), that it would take action to improve the existing system of cost estimation and also promised (January 2000) that it would, in future, carry out detailed examination of the vessel and work out the cost and time estimates with the assistance of Classification Societies such as Lloyd's Register of Shipping (LRS) and Indian Register of Shipping (IRS).

In the course of audit, it was observed that out of total 38 major repair works undertaken during the period under review, in nine cases the cost variations ranged from 21 to 91 per cent involving an additional expenditure of Rs.13.13 crore.

From this, it was evident that in spite of being aware of the problem of cost overruns, no such system of cost estimation and credible mechanism had been established to bring about reasonably accurate cost estimates.

The Management replied (July 2004) that the increase in expenditure was not due to only additional works but also on account of increased quantities and the comparison should be made with reference to estimated cost plus 20 per cent towards unforeseen jobs and not on the basic estimate only.

The reply is not tenable as the Company has been in the business of dredging for nearly three decades and it is expected that it would have developed certain expertise to estimate work packages (the items of repair to be done) more accurately, which, in turn, would help estimate costs more accurately.

12.4.2 Time over-run in repairs

As per the policy of the Company, normal completion period of each regular dry-dock is one month. However, depending on the size of the work package and time quoted by the repair yards, the repair periods are finalised. As the dredgers do not yield any revenue during the dry-dock period, completion of the dry-dock work within the quoted period is essential.

It was observed that out of 38 major repair works undertaken, there were delays in 33 cases. While the delay in 14 cases was minor, the time overrun in 17 cases of regular dry-docks (excluding two emergency cases) was significant and ranged between 17 and 75 days. As a percentage, this delay ranged between 51 per cent and 183 per cent over the quoted time, which adversely affected both production and revenue. The Company suffered a net revenue loss of Rs.14.40 crore after adjusting the liquidated damages of Rs.9.30 crore recovered from the defaulting repair yards in 13 cases.

These time overruns highlight the system deficiency in getting the works done within the contracted periods.

12.4.3 Absence of Standard Schedule of Rates

Standard Schedule of Rates would help to monitor the effective preparation of estimates and to assess the reasonableness of the price bids. This is particularly relevant in cases where the Company either has to award additional works to the same Yard or when the work itself has to be awarded on a nomination basis.

However, it was observed in Audit that the Company, which was in the business for the last 28 years, lacked in-house expertise to prepare cost estimates on its own. It failed to develop a 'Standard Schedule of Rates' based upon accumulated experience and relied on tariff information from the local repair yard viz., Hindustan Shipyard Limited, Visakhapatnam. Consequently, the Company, at times, was not in a position to compare the varying rates from a single repair yard within a short period for identical items of works and was forced to accept the same.

The Management replied (July 2004) that the tariffs of the yards varied on the basis of geographical location and to make the estimates realistic, the tariffs of one of the yards had to be necessarily adopted for the purpose of estimation. Historically, the Company being based at Visakhapatnam, tariff of Hindustan Shipyard Limited had been adopted as the benchmark for estimating the cost of dry-dock repairs.

The reply is not tenable as working out the cost estimates in-house by the Company would provide assurance that the rates quoted were reasonable.

12.5 Deficiencies in Tender Evaluation

The tendering process for deciding on the party which would undertake repairs of dredgers involves evaluation of competing bidders. Unlike in a normal evaluation of tenders where the lowest cost is the key criterion in evaluating price bids, in the case of repair of dredgers additional information regarding revenue loss during the repair period also needs to be considered. Thus, for finalising the decision on the bidders (a) the cost of repair and (b) extent of revenue loss during the quoted repair period and voyage period of the dredger to and from the repair yard, are to be taken into account. As the voyage period is dependent on the speed of a dredger, this is also one of the important considerations in evaluation. This evaluated cost would form the basis for finalisation of

the tender. Further, price preference of 10 per cent is to be given to Public Sector Undertakings (PSUs), if they agree to match the price of the lowest tender of a private party.

In the course of Audit it was observed that in three cases there were shortcomings in evaluation of tenders by the Management as detailed below:

Sl. No.	Dredger / Dry-dock month and year	Repair work assigned to	Facts of the case	Financial implication
a)	Dredge-XI (April 2001)	WISL, Goa	Port of deployment after dry-dock repairs was to be considered as Paradip. However, while evaluating the offers, the Company wrongly considered the same as Kandla. As a result evaluated cost of Hindustan Shipyard Limited Vishakhapatnam (a PSU) became higher than that of Western India Shipyard Limited (WISL), a private party. Even though, HSL offered to undertake repair work at WISL's quoted price and at reduced repair time, order was placed on WISL. The erroneous consideration resulted in loss of six dredging days.	Loss of revenue of Rs.84 lakh. (@ Rs.14 lakh per day for six days)
b)	Dredge-XII (August 2000)	WISL, Goa	By considering the speed of Dredge-XII as eleven nautical miles/hour, instead of the actual speed of nine nautical miles/hour, the offer of HSL Vishakhapatnam was projected to be higher by 12.31 per cent over that of WISL, Goa. Though HSL offered to match the cost of WISL, their offer was ignored and order was placed on WISL. Had the Company accepted the offer of HSL and negotiated there would have been a saving of voyage time by 13.5 days.	Loss of revenue of Rs.2.03 crore. (@ Rs.15 lakh per day for 13.5 days)
c)	Dredge-XI (May 2003)	HSL, Visakha-patnam	The Company cancelled the global tender for repair and finally ended up awarding the tender to the same firm viz., HSL at a higher cost and for a longer repair period.	Excess repair cost of Rs.48.72 lakh and loss of revenue of Rs.32 lakh.

In respect of (a) above, the Management replied (July 2004) that the operations department confirmed in March 2001 Kandla to be the port for deployment after dry-docking and accordingly the tender was evaluated. The reply is not tenable as, firstly, the marketing department clarified (March 2001) that Dredge-XI would be deployed at Kandla or Haldia after dry-dock depending on the performance of another dredger viz., Dredge-IX at Kandla; secondly, Dredge-IX sailed from Haldia to Kandla well before the approval (April 2001) of Tender Committee. As such, it was clear that Dredge-IX had

replaced Dredge-XI at Kandla as it was already in Kandla by the time the approval was obtained. In respect of (b) above, the Management replied (July 2004) that the speed of the vessel was not specified in the tender and for evaluation the speed was considered at eleven nautical miles. The reply is not tenable as the correct speed of the vessel was only nine nautical miles which was confirmed in the subsequent tender invited in January 2002. The Company's action was thus not justified.

In respect of (c) above, the Management replied (July 2004) that it noticed during evaluation that the port of redeployment after dry-docking was erroneously indicated as Kandla instead of Paradip; therefore, the global tender was cancelled. Since HSL stood lowest in the above tender considering Paradip, the work was entrusted to HSL on nomination basis with negotiated 27 per cent discount. The fact remains that the Company had to incur avoidable extra expenditure and suffer loss of revenue because of its own mistake.

Thus, due to wrong evaluation of the tender offers on two occasions and cancellation of global tender in one case, the Company suffered loss of revenue of Rs.3.19 crore and incurred extra expenditure of Rs.48.72 lakh, which were avoidable.

12.6 Execution of repair work

12.6.1 Failure to invoke Security clause against premature failures

The work orders contain a security clause against premature failure of repairs within a period of 90 days. They also stipulate that repairs arising within 90 days would be undertaken by repair yard at their risk and cost.

However, it was observed in Audit that in no case were the provisions of security clause invoked and the Company absorbed the entire repair cost besides sustaining loss of revenue. Two instances are discussed below.

(i) Dredge – IX was dry-docked at Western India Shipyard Limited (WISL), Goa during November and December 2001. However, immediately on completion of repairs during sea trial itself, machinery damages occurred and to rectify these damages/defects, the repair period was extended by 31 days. The Preliminary Inquiry Report (January 2002) concluded that WISL was also responsible for the damages to the machinery. Based on this, the Chairman & Managing Director directed that suitable deductions be made from the repair bill and ordered a final enquiry. However, without waiting for the conclusion of the Final Inquiry Report, based on a note initiated by the operations department, the balance payment of Rs.78 lakh was released (June 2002) without any deductions towards damages to the machinery. The damages/defects during sea trials after dry-dock resulted in additional repairs at a cost of Rs.35.40 lakh and extended period of dry-dock with consequential loss of effective dredging time and revenue of Rs.4.41 crore.

The Management replied (July 2004) that the defects leading to extended dry-dock period were not attributable to the yard and departmental action was taken against the concerned officials of the Company.

The reply is not tenable in view of the facts that

(a) the preliminary enquiry, based on which departmental action was taken against the concerned officials, was ignored for taking action against WISL,

(b) final Inquiry Report findings were not considered at all and

(c) although Mercantile Marine Department (MMD) surveyors were also requested to investigate the matter, the Company failed to obtain MMD's report. Thus, the Company's action of absolving WISL by reversing its own preliminary enquiry findings without considering the final inquiry report and the report of MMD was not in order.

(ii) Dredge-XII was dry-docked (September 1999) on emergency basis at Netaji Subhash Dry Dock, Kolkata mainly to rectify the leakages in bottom doors and the repairs were completed in October 1999. However, in spite of continued leakages from the first day after completion of dry-dock, no penal action was initiated against the repair yard. Further, the Company suffered loss of revenue of Rs.1.99 crore as Kolkata Port Trust - the customer, imposed penalty by deducting this amount from the dredging bills on account of continued bottom door leakages.

The Management replied (July 2004) that after emergency dry-docking the Company could reduce the leakage to 15.39 per cent compared to the leakage of 20 per cent prior to dry-docking at Netaji Subhash Dry Dock, Kolkata and there was reduction in penalty.

The reply is not tenable as the purpose of emergency dry-dock, which was to stop the bottom door leakages, was not met. Further, the reply fails to take note of the repair cost and loss of revenue during the emergency dry-dock amounting to Rs.30 lakh and Rs.3.72 crore respectively.

The above instances highlight the necessity that the Management should initiate penal action against premature failures as provided in the contract so that it is assured of satisfactory repairs.

12.6.2 Sailing dredgers without ensuring dry-dock slots

The Company must ensure the exact availability of dry-dock slots before the Dredgers sail to the repair yards to avoid idling and loss of dredging time due to unnecessary voyages. However, it was observed that the Company allowed the dredgers to sail without first ascertaining the availability of dry-dock slots resulting in idling of the Dredgers, infructuous expenditure towards voyage and loss of time. Some illustrative cases are discussed below:

(i) Dredge V was allowed to sail from Haldia to Hindustan Shipyard Limited (HSL), Visakhapatnam, in September 1999, at a time when HSL was not in a position to undertake the repairs. Since no dry-dock slot was available, the vessel was sent back to Haldia and commenced dredging in October 1999. Thus, due to sailing without confirming the availability of dry-dock slot, 12 dredging days were lost, resulting in loss of revenue of Rs.84 lakh.

The Management replied (July 2004) that HSL informed that their dry-dock was not available for Dredge-V and when the Company contacted Haldia to ascertain the status of the vessel, it was learnt that the vessel had already started sailing to Visakhapatnam.

The reply is not tenable as the Management should not have allowed the vessel to sail without obtaining a date for dry-docking at HSL. It could have also taken immediate action to give instructions to the Dredge Master en-route to return to Haldia.

(ii) With the intention to dry dock Dredge XVI at Cochin Shipyard Limited (CSL), Kochi, the vessel was allowed to sail (May 2002) from Taichung, Taiwan, without even contacting CSL. When CSL expressed its inability to undertake the repairs, having no alternative the Company deployed the dredger for Kochi Navy's work for a brief period of two weeks. Meanwhile, when a dry-dock slot was obtained at HSL, the Dredger undertook voyages to Visakhapatnam and, after dry-dock repairs, to Goa for commercial operations. Had the Company ascertained the availability of dry dock slots from both HSL and CSL before the vessel sailed from Taichung, there would have been substantial saving in voyage time of about five days by sailing it directly to Visakhapatnam and a loss of revenue of Rs.88 lakh would have been avoided.

The Management replied (July 2004) that on completion of assignment at Taichung the vessel sailed to Cochin to be deployed for Cochin Navy assignment and to dock the vessel at CSL. When no slot was available at CSL, the vessel was brought to Visakhapatnam. The voyage to HSL was inevitable.

The reply is not tenable as the Company did not contact HSL also from Taichung. It contacted only CSL and allowed the vessel to directly sail to Cochin without confirming the availability of dry dock slot at CSL. The above, illustrations indicate lapses on the part of the Company in not ascertaining the dry-dock slots before sailing the dredgers. Such lapses need to be reviewed by the Management.

12.7 Material Management

The Company procures all stores and spares required for maintenance / repairs on specific requirement and issues them Dredgers for consumption/replacement. More than 90 per cent of the stores and spares are imported and in most of the cases, materials are procured on proprietary basis. An expenditure of Rs.185.13 crore was incurred on spares and stores during 1999-00 to 2003-04. A scrutiny of the activity of 'Material Management and Inventory Control' in the Company revealed the following:

12.7.1 Absence of inventory control tools

Inventory control tools like "ABC Analysis", "Vital, Essential and Desirable (VED) Analysis", "Fast/slow Moving, Analysis" would help the Management to exercise effective inventory control. The technical consultants engaged by the Company, M/s. KPMG, also opined (March 2001) that the Company should have implemented VED Analysis to effect better material management.

However, it was observed that the Company had not fixed any maximum or minimum levels of stores and spares to be maintained in the central stores at Head Office/on board the Dredgers. Inventory control tools like "ABC Analysis", "VED Analysis", "Fast/slow Moving, Analysis", etc., were also not being employed.

The Management replied (July 2004) that though VED analysis was ideal for the Company, the same could not be implemented due to a number of variable factors peculiar to dredging industry.

The reply of the Management is not tenable in view of the fact that Management has itself accepted the report of KPMG in this regard.

12.7.2 Inventory holdings on board the dredgers

All dredgers of the Company maintain substantial quantities of stores and spares on board the dredger. As per the policy of the Company, all purchases are made against indents raised by the dredgers. The indents are to be raised against specific requirement. For effecting better inventory control, it is required to maintain both financial and numerical accounts of the inventory. However, the accounting policy of the Company with reference to consumption of stores and spares is such that the inventory is treated as consumed, irrespective of value, as soon as it is issued to the dredger and not at the time of actual consumption.

Adoption of the above accounting policy resulted in a situation where inventory, though physically available on board the dredgers, is not reflected in the financial accounts. Non-maintenance of financial accounts, over a period of time, resulted in Company's inability to value all the inventory items. When the Management attempted to assign values to the existing on board inventory, only 14,312 types of items out of 18,385 items on board of 11 out of 12 dredgers at the end of March 2004 could be valued, which amounted to Rs.77.08 crore. In the absence of proper financial accounts, the chances of misappropriation cannot be ruled out.

The Management replied (July 2004) that

(i) the Company was in the process of streamlining the teething problems and action was on hand to improve document procedure, etc and

(ii) in view of the working environment of the dredgers, it was necessary to keep sufficient quantity of spares on board the dredgers.

The reply of the Management is not tenable since:

(i) considering that the Company was in operation for the last 28 years such controls should have been in place and

(ii) the Management did not furnish any specific justification for the increasing trend in the on board inventory.

12.8 Recommendations

(a) The Company should improve the planning of dry docking of vessels so that all dredgers are dry docked when due and statutory surveys are conducted during the regular dry docks in order that they are not dry-docked exclusively for surveys.

(b) The Company should create immediately, for each dredger, a database of all defects (work packages), costs (estimated and actual), repair history, spares consumed, etc. and data of production performance (dredge per hour, fuel per hour, etc.) together with variable factors such as location and tidal conditions, should be captured and analysed on a regular basis. Such a database would be a useful Management Information System to take decisions on cost and time for repairs more accurately.

(c) The Management should avoid, as far as possible, awarding repairs on nomination basis. Where it is inevitable, in emergencies, it should have a mechanism of satisfying itself that the costs are reasonable.

(d) The Company must improve its on board spares management. It must maintain value records and not merely the quantities and also reflect the same in financial accounts.

The review was issued to the Ministry in September 2004; its reply was awaited (March 2005).

MINISTRY OF SMALL SCALE INDUSTRIES AND AGRO AND RURAL INDUSTIRES

CHAPTER : XIII

National Small Industries Corporation Limited

Loan Assistance and Recovery Performance

Highlights

The National Small Industries Corporation Limited (Company), which was incorporated in February 1955 with the main objective of assisting, promoting and developing the growth of small industries in the country, earned profit till 1999-2000 but started incurring losses thereafter. However, it earned a marginal profit of Rs.1.48 crore during 2003-04. The accumulated losses as on 31 March 2004 were Rs.143.52 crore. High incidence of Non Performing Assets (NPA) was the main reason for losses.

(Paras 13.1 and 13.4)

The achievement vis-à-vis targets under four major financing activities for the years 1998-99 to 2003-04 ranged between 22 to 90 per cent (except under Raw Material Assistance and Bill Discounting for 2000-01).

(Para 13.6)

Due to poor recovery performance, the Non Performing Assets (NPA) as on 31 March 2004 were Rs.184.97 crore representing 86 per cent of the total over due of Rs.215.56 crore in respect of four activities namely Hire Purchase, Equipment Leasing, Raw Material Assistance and Bill Discounting. The Company, thus, had to avail loan from Small Industries Development Bank of India and paid avoidable interest of Rs.22.95 crore for the period from 1998-99 to 2003-04. Test check revealed deficiencies in appraisal, sanction and follow up which contributed to non-recovery of Rs.18.61 crore in 24 cases.

(Paras 13.7 and 13.8)

Revenue Recovery Certificates were issued in three states viz., Uttar Pradesh, Madhya Pradesh and Gujarat, but the Company could not collect Rs.49.75 crore in 367 cases due to ineffective action.

(Para 13.9)

The Company could not execute decrees in 816 cases involving Rs.36.51 crore due to laxity in follow up action. Besides, chances of recovery are remote in another 12 cases involving Rs.37.34 crore.

(Para 13.10)

Due to failure to monitor timely disposal of seized machinery in two regions and two branches, the Company lost Rs.1.89 crore.

(Para 13.12)

13.1 Introduction

The National Small Industries Corporation Limited (Company) was incorporated in February 1955 with a corporate mission to aid, counsel, assist, finance, protect, and promote the interest of small industries in India. The present activities of the Company are (i) financing including grant of composite term loan and machinery assistance, (ii) marketing both internal and for export of materials and machinery, (iii) promotional and (iv) setting up of Software Technology Park.

The Government of India entrusted to the Company (March 2000) the implementation of the programme of development of small and medium enterprises under Italian Line of Credit*. As per the Memorandum of Association, the Company is empowered to assist only small industries whose fixed investment in plant & machinery is upto Rs.one crore. It should be examined if an amendment to the Memorandum of Association is required for providing financial assistance (upto Rs.five crore) to medium industries under Italian line of credit.

13.2 Organisational structure

The Board of Directors of the Company consists of a Chairman-cum-Managing Director and two fulltime functional Directors, (one in charge of planning and marketing and the other for finance) apart from an Executive Director to monitor vigilance cases and Employees Provident Fund Trust. The Company has nine regional offices, 24 branch offices, 23 sub offices and two foreign offices at Johannesburg and Dubai.

13.3 Scope of Audit

The review covers the performance of the Company under major financing activities viz., Hire Purchase (HP), Equipment Leasing (EL), Raw-Material Assistance (RMA) and Bill-Discounting (BD) and Marketing Activities for the five years ending 31 March 2004. The records of five Regional Offices of the Company viz., Kolkata, Chennai, Ahmedabad, Mumbai and Noida and seven Branch Offices viz., Allahabad, Kanpur, Bangalore, Jaipur, Delhi, Indore and Ludhiana were scrutinised in respect of the cases where disbursements exceeded Rs.10 lakh.

13.4 Financial position and working results

The summarised financial position, working results and the performance of financing activities of the Company for the last five years ending March 2004 are given in Annexures 7, 8 and 9. There was a gradual decrease of the Capital employed from Rs.472.15 crore (1999-2000) to Rs.183.69 crore (2003-04). Networth also decreased from Rs.173.23 crore (1999-2000) to Rs.23.69 crore (2002-03) though slightly increased to Rs.44.46 crore (2003-04). It was observed that the Company showed profits till 1999-2000 as the provision for bad and doubtful debts was marginal. Once the provisions were raised to realistic level, the losses became visible. The Company had to make huge provision of Rs.114.29 crore for doubtful debts during the years 1999-2000 to 2001-02. The Company incurred a loss of Rs.12.36 crore during 2002-03 in spite of making no additional provision of Rs.47 crore for bad and doubtful debts as recommended by M/s. A.F.Ferguson & Co (consultant). No provision was made for doubtful debts during the year 2003-04. After incurring losses for three consecutive years the Company showed a

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* ***The loan provided by the Government of Italy to be utilised for acquisition of Italian machinery and services.***

marginal profit of Rs.1.48 crore during 2003-04 and the accumulated losses stood at Rs.143.52 crore as on 31 March 2004.

13.5 Restructuring plan

M/s. A.F.Ferguson & Company, the Consultant appointed for restructuring plan, recommended (July 2002) increase in the focus of the Company on non-financial services such as setting up of sector/cluster specific groups so as to become a commercially self-sustaining organisation over a period of five years. The Government of India, while approving the restructuring plan, instructed the Company (February 2003) to earn operating profit effective from April 2004, reduce manpower from 980 to 850 and discontinue financing activities except for those related to technology upgradation from April 2007. Audit observed (July 2004) that while the nomination of Cluster Development Managers in 26 locations was completed by January 2004, there was no progress in implementation of remaining restructuring plan items such as acting as a coordinator for technology acquisition, setting up of incubation centres for emerging technology areas etc. The Management stated (July 2004) that the Company would have to earn profit from 1 April 2004 and reduce manpower to 850 by the end of March 2004. Thus, the performance could be assessed only after the close of financial year 2004-05. The Company, however, continued with 966 employees on its roll as on 31 March 2004.

13.6 Targets and achievements for disbursements:

The norms for financial assistance and procedure for sanction and disbursement including repayment period are indicated in Annexure-10. The targets (budgeted) and achievements for disbursements under four major financing activities for the last five years upto 2003-04 were as under:

(Rs. in crore)

Year	Hire Purchase and Equipment Leasing			Raw Material Assistance and Bill Discounting		
	Target	Achieve -ment	Percentage	Target	Achieve-ment	Percentage
1999-00	50.00	26.55	53	974.52	786.03	81
2000-01	55.00	26.07	47	779.75	778.66	100
2001-02	55.35	20.91	38	779.75	703.79	90
2002-03	55.00	13.95	25	740.00	516.44	70
2003-04*	35.20	7.73	22	346.50	184.25	53

*The targets for 2003-04 are as per restructuring plan.

(i) In respect of Hire Purchase and Equipment Leasing, the percentage of achievement ranged between 53 (1999-00) and 22 (2003-04). The main reason for non-achievement of the targets was incidence of high default in various schemes coupled with high interest rates charged by the Company compared to other financial institutions.

(ii) In respect of Raw Material Assistance and Bill Discounting, the Company reduced the target in all the years and accorded it low priority. The achievement declined during 2001-02 (90 per cent) to 2003-04 (53 per cent). The Management stated (July 2004) that the performance was poor due to incidence of high default and discontinuance of Bill Discounting scheme and the interest rates of other financial institutions were not strictly comparable because they offer a range of integrated services. Audit, however, noticed that discontinuance of Bill Discounting scheme was due to failure to obtain security and lack of monitoring.

Assisted units took undue advantage resulting in blockage of huge funds of the Company. The Company reduced its disbursement to 24 per cent in 2003-04 in comparison to 1999-2000 to check the increase in non-performing assets (as discussed in para 13.8) and accumulation of overdues for long periods (as discussed in para 13.7).

Review in Audit further showed that the Company had been extending financial assistance to various types of industries. Though it had maintained a database relating to Sector/Region/State/District upto 2001-02, it was not utilised during sanction and appraisal to ensure that industries, which had adequate potential, could be given higher assistance. Further, the Company should have maintained industry wise databank of defaulters for fixing limits for financial assistance based on recovery performance of assisted units.

The Management stated (July 2004) that branches were being once again advised to keep in view the exposure norm° for each sector while sanctioning the applications for assistance.

13.7 Recovery performance

Timely and effective recovery of dues is the most critical component for any financing company for sustaining its capacity to finance and reduce risks on its debts. The Company had no system of assessing the recovery performance of each branch till April 2004, when each branch was declared an independent profit centre.

The table below indicates the recovery performance of the Company in respect of four major activities for the year 2003-04:

(Rs. in crore)

	Hire purchase	**Equipment leasing**	**Raw material assistance**	**Bill discount-ing**	**Total**
(a) Amount due at the beginning of the year	86.13	14.07	122.72	31.94	254.86
(b) Fallen due during the year	17.18	2.28	110.58	0.75	130.79
(c) Total recoverable (a + b)	103.31	16.35	233.30	32.69	385.65
(d) Old dues recovered	5.75	1.81	26.26	8.49	42.31
(e) Current dues recovered	11.98	1.54	96.80	0.48	110.80
(f) Amount due at the end of the year (c-d-e)	85.58	13.00	110.24	23.72	232.54
(g) Old dues recovered as a percentage of amount due at the beginning of the year	6.7	12.9	21.4	26.6	16.6
(h) Current dues recovered as a percentage of amount fallen due during the year	69.7	67.5	87.5	64	84.7

The Company fixed a target for recovery at 80 per cent and 20 per cent in respect of current dues and old dues respectively. The target of recovery of current dues could not be achieved for Hire-Purchase, Equipment Leasing and Bill Discounting and target for recovery of old dues could not be achieved for Hire-Purchase and Equipment Leasing.

° *financial limit and other factors*

This led to accumulation of overdues (Rs.232.54 crore) affecting the cashflow for advancing new loans.

An analysis of region-wise performance of recovery revealed that except in North I and South I regions, the recovery percentage was less than 50 in every region. The lowest recovery percentage was noticed in Head Office Marketing division where it was only six per cent. Further analysis indicated that out of 30 cases pending for recovery (Rs.17.48 crore) in Head Office Marketing division, four cases (Rs.11.33 crore) were referred to the Central Bureau of Investigation (CBI) for investigation and 23 cases (Rs.5.91 crore) were pending at various stages in courts (November 2004).

Audit noticed (May 2004) that the Company had not ascertained the dues recovered under each activity against total dues recoverable including arrears. Further, principal and interest components were not being maintained separately by the Company at the Corporate Office. An attempt was made in audit to ascertain the trend/status of recovery of dues under four major activities in five Regional Offices and seven Branch Offices upto the period 2002-03 (Annexure-11). The trend analysis of recovery of dues in audit indicates that recovery under Hire Purchase scheme ranged between 11.9 and 15.3 per cent. Under Equipment Leasing, the recovery was between 24 and 44 per cent only which indicates failure of the Company to effectively recover its dues.

Age-wise details of overdues as on 31 March 2004 indicated that no timely action for recovery was initiated as the period of overdues exceeded the repayment period (five years for HP and EL and 90 days for RMA and BD) for each activity as follows.

(Rs. in crore)

Period	**HP**	**EL**	**RMA**	**BD**	**Total***	**Percent**
Up to 100 days	--	--	16.48	--	16.48	7.6
Below one year	5.36	0.54	8.21	--	14.11	6.5
One to three years	5.97	1.16	3.56	2.26	12.95	6.0
Three to five years	5.40	2.69	93.27#	20.40#	121.76	56.5
Above five years	45.17	5.09	N.A.	N.A.	50.26	23.4
Total	**61.90**	**9.48**	**121.52**	**22.66**	**215.56****	**100.0**

*Figures are provisional

** Variation of Rs.16.98 crore between this figure (Rs.215.56 crore) and figure shown in table in sub para 2 (Rs.232.54 crore) which was yet to be reconciled by the Management.

Includes above five years also.

Of the above, dues amounting to Rs.89.69 crore (RMA and BD) were not backed by any security, a pointer towards non-observance of pre-sanction appraisal procedures. In Ahmedabad region the Company obtained security worth Rs.4.29 crore by way of shares from four of the assisted units which could not fetch any value against the dues of Rs.6.26 crore. Even under the secured category where the Company had obtained collateral securities in the form of land and buildings etc. amounting to Rs.19.49 crore, it had not assessed the realisable value of securities held.

The poor recovery performance of the Company created cash crunch situation. Consequently as the credit limit available from commercial banks had been exhausted, it had to increase its loan component from the Small Industries Development Bank of India (SIDBI) from Rs.20 crore in February 1998 to Rs.70 crore in December 2000. This resulted in payment of interest of Rs.22.95 crore from 1998-99 to 2003-04. The loan was repaid in March 2004.

The Management, while accepting (July 2004) that recovery performance was poor in respect of Hire Purchase, maintained that it had achieved overall recovery of 102 per cent for the period from 1998-99 to 2002-03 for total amount recovered against current and old dues during the year as a percentage of amount fallen due for current dues during the year. The Management further stated that the debts that remained unrecovered for a long period were due to filing of suits against the defaulters in courts. The Company had constituted a recovery cell in the Corporate Office (July 2003) which was updating the data on the overdues as on 31 March 2003. Contrary to management assertions, the overall recovery percentage considering the amount due at the beginning of the year and fallen due during 2001-02 to 2003-04 got reduced from 57 to 51 in 2002-03 and 40 in 2003-04. Since the performance of recoveries is critical to its overall financial health, the company needs to focus on its recovery mechanism to improve its performance.

13.8 Non-performing assets, deficiencies in appraisal, sanction and ineffective post-disbursement follow-up

An asset becomes a Non-Performing Asset (NPA) when it ceases to generate income for an institution. Loan assets can be classified into Standard, Sub-Standard, Doubtful and Loss Assets. The loan assets falling under the categories other than standard are NPA.

The Company identified NPA worth Rs.259.21 crore in April 2001 for dues upto March 2001, constituting 71 per cent of the total overdues (Rs.362.56 crore).

Scrutiny in Audit revealed (May 2004) that out of 71 per cent of NPA, 59 per cent (Rs.215.15 crore) fell in the category of Doubtful and Loss assets indicating remote possibility of recovery. In two regions (Ahmedabad and the Head Office Marketing division) the NPA was as high as 100 per cent of the total overdue outstanding in these regions. There was high incidence of NPA in respect of 51 cases in six regions/branches due to irregular grant of assistance such as absence of inspection of units before disbursement, defective pre-sanction appraisal and failure to obtain securities under raw material assistance and bill discounting schemes. These 51 cases (Rs.64.31 crore) were referred to CBI.

The Company did not make any attempt to identify NPA subsequent to April 2001. Based on the agewise details of overdues (Rs.215.56 crore) in respect of four activities as on 31 March 2004 (as discussed in para 13.7), NPA stood at Rs.184.97 crore and this worked out to 86 per cent, indicating poor credit risk management.

A test check of 60 cases by Audit in six regions revealed that in respect of 16 cases (Hire-Purchase and Equipment Leasing) for which assistance of Rs.6.54 crore was extended and eight cases (Raw Material Assistance/Bill Discounting) where assistance of Rs.13.94 crore was extended during the period 1998-99 to 2002-03, default occurred within a short span of three years during November 1999 to April 2003 resulting in overdues amounting to Rs.18.61 crore as NPA. The reasons were deficiencies in appraisal, sanction and ineffective post-disbursement follow-up such as viability of the project not ascertained, lack of working capital, failure to obtain bank guarantee, failure to inspect the unit, delay in seizure of machines etc as detailed below:

(Rs. in lakh)

Name of the unit	Month of disbur-sement	Amt. of assist-ance	Month of default	Amount overdue (March 2004)	Audit findings
Hire Purchase					
1. Shiva Poly Pax (P) Ltd., Noida	2/1999 to 7/1999	132.00	3/2000	64.26	Failure to ascertain the availability of working capital arrangements. The Company failed to obtain proper security. NRI promoter expired and unit had been closed. No action taken to invoke personal guarantee of other directors.
2. Moira Wire Ltd., Indore	8/1998 & 11/1998	85.04	2/2000	71.42	Failure to ascertain the fact of assistance provided by other institutions resulted in seizure and selling of machines by them. Inordinate delay in seizure of machines and non-disposal of mortgaged land.
3. Viknesh Knits, Coimbatore	8/2002	93.28	3/2003	17.92	Failure to ascertain the viability of the project and market potential, as the unit failed for want of job orders.
4. Ally Packaging Allahabad	5/1999 to 8/1999	24.32	9/2000	38.73	Failure to obtain collateral security before disbursement of loan. Non-verification of misrepresentation about the working capital arrangements.
5.Hanuman Bricks (P) Ltd., Agra	3/1999 & 7/1999	38.02	12/1999	23.92	Failure to ascertain the availability of working capital and managerial skill of the directors, failure to verify the valuation of the collateral security (overvalued by Rs.10.86 lakh) and non-seizure of machines.
6. Kirubha Graphic Systems,Chennai	12/2000	29.04	12/2002	9.78	Failure to ascertain market potential and the competition.
7.A.T.Traders Delhi	8/1999	30.09	3/2000	24.22	Failure to take possession of the machinery and to invoke personal guarantee and delay of three years in filing suit. The Court remarked that the interests of the Company were not safeguarded while sanctioning the loan.
8. Kleenmart Chennai	2/1999	24.60	9/1999	21.43	Failure to ascertain the viability of the project leading to change in the status of unit from sole proprietorship to

					partnership and subsequent failure of the unit. Seized machinery still lying undisposed.
9. Eureka Enterprises, Coimbatore	9/1999 to 2/2000	36.68	5/2002	6.14	Dispute among partners and delayed issue (July 2003) of notice for seizure of machines by more than a year. The unit on the contrary filed a writ in the High Court not to seize the machines contesting the action of the Company as arbitrary.
10.Raghavendra Industries Madurai	5/1999	56.60	6/2000	17.10	Failure to ascertain the excessive borrowings and financial credential of the promoter. Failure to monitor the misutilisation of funds. The Unit is presently under liquidation.
11. Foto Fast Studio Ratlam. (Indore)	10/1998	16.80	3/2000	8.20	Disbursing assistance for defective machinery without verifying/inspecting the same before disbursement.
12. Angala Parameshwari Industries, Chennai	3/1999	21.72	6/2000	12.59	Failure to ascertain the financial background of the promoters as they availed loans from other financial institutions and are not traceable.
13. Richie Enterprises, Chennai	4/2002	15.76	4/2003	8.36	Failure to ascertain the market potential, availability of continuous power supply/ working capital and restrictions imposed by pollution control board.
14. Shiva Food Products Noida	10/1998 and 11/1998	13.53	5/1999	7.22	Failure to ascertain the viability of the project, as the unit could not even pay rent and electricity charges and promoter not traceable. Seized machinery still undisposed.
Equipment Leasing					
15. S.S. Computers, Indore	5/1999	18.79	3/2000	17.91	Failure to verify the correctness of supply of computer and software with the order placed before disbursement. Subsequent inspection revealed non-availability of computers (July 2002).
16. Sarvodaya Labs Mumbai	12/1998	18.15	12/1999	23.19	Failure to seize the machine in November 2000 as the unit was subsequently taken over by the unit's bankers (March 2004) and the case is referred to Debt Recovery Tribunal by Bankers.

Raw Material Assistance					
17. 14 SSI units Kolkatta	1998	837.00	1998-99	949.71	Non-concurrence to change of Bank for Discounting of Bills, (Kerala State Electricity Board), failure to ensure supply of material and to pursue for payment with Electricity Boards. Company's funds remain unrecovered for more than four to five years.
18. Leela Apparels Coimbatore	9/1998	50.00	11/2000	40.60	Failure to ascertain the viability of the project, as the unit failed to obtain orders. Even the availability of working capital was not ascertained.
19. Hanung Toys Noida	11/1996	75.00	6/1999	50.03	Failure to verify the genuineness of import documents and ascertain the managerial skill of the promoter as the unit could not get orders.
Bill discounting					
20. Seven SSI units Jaipur	7/1999	200.0	12/1999	200.03	Providing assistance in excess of bank guarantee as a concession but no precaution was taken to recover while extending concession.
21. Mohan Conductors Bangalore	5/1998 to 7/1998	100.00	5/1998	50.45	Disbursement made without collecting necessary documents towards Letter of Credit. Later on bankers refused payment due to inadequate documentation.
22. Fidelity Industries, Chennai	7/1999	40.00	10/1999	40.94	Failure to ascertain creditworthiness of the promoter. Failure to obtain Bank guarantee as required.
23. Astral Cables Noida	10/1999 to 7/2000	54.46	10/2000	111.09	Failed to ascertain the supply position before discounting of bills and before releasing payment. Bank guarantee not extended and expired.
24. RSL Industries Chennai	7/1999	37.85	4/2002	45.79	Excessive borrowing by the unit.
Total				**Rs.18.61 crore**	

Out of 24 cases, three cases of default were due to non availability of working capital, four cases due to non-seizure of machinery, seven cases due to non-viability of project and six cases due to failure to obtain bank guarantee.

The Management admitted (July 2004) that the Company would have to strengthen its pre-disbursal mechanism, post-disbursal follow-up and monitoring and recovery

mechanism for effective repayment of dues from the units. The Management further stated (July 2004) that it had initiated several corrective steps and strengthened the pre-sanction appraisal norms. The field offices were being directed to follow up with the defaulting units vigorously to ensure that default was minimised.

13.9 Recovery through Revenue Recovery Certificates

As per procedure, the Company needs to be empowered by the respective State Government for recovering dues under the respective State Revenue Recovery Act as land revenue authority through notification. It was observed that the Company initiated action for recovery of dues under Revenue Recovery Act in only three States viz. Uttar Pradesh, Gujarat and Madhya Pradesh. Even in these States, the pursuance of the Revenue Recovery Certificates (RRC) issued by the Company was negligible. Against the 367 Recovery Certificates amounting to Rs.50.03 crore, the Company could recover only Rs.28.43 lakh which worked out to a meagre 0.57 per cent of the total recovery due under RRC.

It was further noticed in Audit (May 2004) that the Company approached (December 2003) the Gujarat High Court to direct the State Government to expedite recovery of the RRC issued by it. The Government of Gujarat is required to comply with court's directions. Similar steps were not initiated by the Company in other two States to expedite recovery of RRCs.

The Management stated (July 2004) that the matter of non-compliance by the Government of Gujarat was again being taken up with the High Court. As regards Uttar Pradesh and Madhya Pradesh regions, the matter was still under consideration of the Company.

13.10 Loss due to ineffective follow up in legal cases

Upto March 2004, 2053 civil suits/petitions for recovery of dues amounting to Rs.181.66 crore were pending in various courts as tabulated below:

(Rs. in crore)

	No. of cases	Amount
Pending in court	1237	145.15
Decrees under execution	499	24.81
Decrees not executed	317	11.70
Total	2053	181.66

Scrutiny in Audit revealed the following (May 2004):

(i) Year-wise details of cases pending in courts were not maintained in branches/regions/corporate office.

(ii) Where agreements were terminated under Hire Purchase scheme, suits for recovery were to be filed within a period of three years. Review in Audit revealed (May 2004) that the Company lost an amount of Rs.53.18 lakh as on 31 March 2004 as it failed to file suits within the prescribed time limit.

The Management stated (July 2004) that it was exploring the possibility of initiating legal action under Article 112 of the Limitation Act, 1963 wherein the limitation was available for 30 years.

(iii) The Company could not initiate execution proceedings for decrees obtained between April 1995 and August 2002 in 17 cases (Ludhiana branch) involving Rs.51.12 lakh due to failure to obtain "Transfer Certificate" from the District Courts, Delhi.

(iv) There was a delay of two to three years in respect of 21 cases amounting to Rs.12.82 crore in filing civil suits filed between April 1998 and August 1999 in Ahmedabad region for the defaults in 1995-96 to 1996-97.

(v) Audit further observed that in 12 cases of Noida, Ahmedabad, Mumbai and Chennai regions, an amount of Rs.37.34 crore was in default. Chances of recovery in these cases were remote for reasons detailed below against each case.

(Rupees in crore)

Name of the unit	Activity	Overdue amount	Audit Observation
Cases pending in courts:			
Morghan Technologies Noida	R.M.A.	1.14	Providing assistance in excess of bank guarantee and failure to obtain proof of materials received. Default occurred in March 1999. Revenue Recovery Certificate issued in January 2001 and suit filed in April 2002.
Parshwa Engineering Group Nagpur	R.M.A.	1.36	Providing assistance in excess of the limits sanctioned. Not referring the case to vigilance department as directed by CMD in May 2001.
Bassein Metals (P) Ltd., Mumbai	R.M.A.	3.68	Failure to obtain security and providing assistance in excess of limit sanctioned. Initiated winding up petition (8/2001) of the assisted unit against legal opinion. Court declared the unit wound up (April 2002).
M.M.Corporation Hong Kong. Moti Industries (P) Ltd Kamal Traders Mumbai (under same group)	Export R.M.A. R.M.A.	5.50	Failure to verify the details of the foreign purchaser. Delay in submitting the claims leading to rejection of claim by Export Credit Guarantee Corporation of India. Suit filed in Hongkong (November 2002) and the chances of recovery were remote as per the legal counsel.
Siddharth Pharma- Chem New Delhi	R.M.A.	0.89	Suit filed (October 2000) but notice could not be served upto March 2003. Promoter expired (March 2003).
Miracle Plast Hinglaj Plast Karishma Plastic Super Pack Plast (under same group)	R.M.A.	3.17 3.04 2.93 2.63	The court discharged (August 2000) the notice of motion and listed under "long cause cases" due to non attendance of the legal counsel depriving the Company of the chance to initiate restraint proceeding against the disposal of promoters' personal properties.
SSI Products Marketing Organisation Ltd.,New Delhi	B.D.	0.37	Suit filed in August 1999. The assistance was without security. Other dues could not be included in the suit for non-availability of details of the amount to be recovered.
Equipment Conductors & Cables Ltd., New Delhi	B.D.	9.11	Failure to assess the viability at any point of time during the grant of assistance (September 1994 to November 1999). In spite of default in November 1999, suit filed only in November 2000.
Earnest Health Care Mumbai	B.D.	0.32	Failure to file suit immediately on default (1996). Case was filed only in 1999. Meanwhile, the unit's bankers filed a winding up petition (1997).

Pamban Oil Chennai	B.D.	0.24	Failure to ascertain the availability of raw material. Unit was closed. (September 1997). Failed to initiate steps to expedite recovery.
Triple Pack Noida	E.L.	1.08	Failed to withdraw assistance under RMA immediately on default (April 1997) under HP. Unit also went into liquidation.
Shristi Auto Engineering, Delhi	H.P.	1.88	Failure to contest the case properly in terms of agreement conditions for the grant of loan against the contention of charging high rate of interest by the assisted unit and inability to get the stay vacated (more than three years) till date.
Total		**37.34**	

Note:
R.M.A. = Raw Material Assistance B.D. = Bill Discounting
E.L. = Equipment Leasing H.P. = Hire Purchase

(vi) In two cases viz., Kingston Electronics, New Delhi (Rs.2.44 crore) and U Pack, Ahmedabad (Rs.5.78 crore) the Company suffered a loss of Rs.8.22 crore as in both the cases decrees were obtained but could not be executed as the promoters were not traceable.

(vii) Besides, the Company could not recover Rs.28.29 crore in 814 cases even after spending about Rs.1.41 crore towards court fees.

The deficiencies in appraisal and failure in follow-up thus resulted in non-recovery of Rs.73.85 crore in 828 cases.

The Management stated (July 2004) that they had introduced a system for proper follow-up and monitoring of the cases by implementing card system and monthly development report, (since July 2004) the results of which would be known in future.

13.11 Failure to initiate action to recover dues under other Acts.

As per the provisions of the Recovery of Debts due to Banks and Financial Institutions Act, 1993, any other institution as notified by the Central Government would be empowered to approach Debt Recovery Tribunal (DRT). It was noticed that the Company did not explore the possibility of notification by the Central Government empowering the Company to approach the DRT or a notification under the Securitisation & Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 to enhance its powers to enforce recovery against its borrowers.

The Management stated (July 2004) that the Company was neither a financial corporation nor a non-banking financial institution and hence it did not come within the purview of the provisions of the Recovery of Debts due to Banks and Financial Institutions Act, 1993. Since the Company proposed to enlist itself under Debt Recovery Tribunal (January 2002), it could have also taken up the matter with the Government for notifying itself as a public financial institution under the relevant Acts so that it could seek more powers to enforce speedy recovery.

13.12 Loss due to delay in disposal of repossessed machinery

As on 31 March 2004, the Company had seized machinery worth Rs.2.81 crore* in eight regions. No details were, however, available at the Corporate office about the status of its

* *under hire purchase Rs.65 lakh and equipment leasing Rs.2.16 crore*

disposal. Review in Audit of the details collected from two regions[#] and two branches[#] revealed that the Company had not disposed of the 69 seized machines (reserve price Rs.32.63 lakh) against which it had to realise an amount of Rs.2.15 crore from the assisted units. Of the 69 seized machines, 47 (reserve price Rs.21.22 lakh) were held for a period exceeding five years.

The Company did not have a system of ascertaining the market value of the seized machinery. It fixed the reserve price by merely taking into account the depreciated value on the date of seizure.

Thus, failure of the Company to monitor the timely disposal of the seized machinery resulted in a loss of Rs.1.89[**]crore.

The Management stated (July 2004) that introduction of fresh policy for expeditious sale of seized machinery was under process.

13.13 Risk management

The Company had not designed any effective policy to identify, assess and monitor credit, market and operational risks in order to achieve financial soundness and profitability.

A very high level of NPA (86 per cent as on 31 March 2004) indicates that the Company failed to evolve a system of addressing its most significant risk, namely, credit risk. Further, the high incidence of cases (51 cases involving Rs.64.31 crore) referred to the CBI is an indication that it failed to identify operational risk.

The Management stated (July 2004) that it had strengthened the appraisal system. As the recovery performance continued to be poor even during 2003-04 effective action is required to be taken to reduce the risks.

13.14 Internal Audit

The statutory auditors in their reports for the years 1999-2000 to 2002-2003 had commented about the inadequacy of internal audit and emphasised in the report for the year 2003-04 that it needed to be strengthened. Further, the auditors had stated that transactions of many of the regional/branch offices were not covered every year and there were arrears in conduct of audit. Due to arrears in coverage of internal audit, the Company failed to detect the continued assistance (Rs.3.33 crore) provided (1999-2000) under Bill Discounting scheme to a Jaipur firm, which received payment from the State Electricity Board on the bills which were already discounted with the Company. The Company noticed this fraudulent case in February 2002 after a lapse of more than two years. Had internal audit been carried out either in 1999-2000 or 2000-2001, the Company could have noticed the fraud and taken remedial measure to strengthen the system of financing.

The Management stated that it had strengthened the internal audit to cover all the offices from 2003-04 (July 2004). However, arrears in internal audit continued to prevail. The internal audit reports, which are submitted to the Audit sub-committee, also need to be placed before the Board of Directors.

[#] *Mumbai and Ahmedabad regions; Indore and Ludhiana branches*

[**] *Rs.2.15 crore minus reserve price of Rs. 33 lakh plus rent Rs. 7 lakh.*

13.15 Conclusions

The Company was incorporated to provide financial assistance to small industrial units for industrial development of the country. However, due to the deficiencies in pre-sanction appraisals and weak recovery mechanism, a very large percentage of its debts have become bad and doubtful. The Company is saddled with a large number of court cases, effective pursuance of which was found wanting. Efforts to enforce recovery through Revenue Recovery Certificates are also inadequate and have not yielded tangible results. As a result, the financial position of the Company shows a declining trend and the Non Performing Assets are growing at an alarming pace, requiring urgent remedial steps.

13.16 Recommendations

It is recommended that the Company should initiate urgent corrective measures and focus on:

(a) Revamping its pre-sanction appraisals mechanism and adhering to procedures before sanction and disbursement of loans.

(b) Maintaining and utilising industry wise data in each region for fixation of exposure limits against each industry/activity to reduce credit risk.

(c) Improving the recovery performance and reducing the high ratio of Non Performing Assets through regular follow-up of dues by conducting periodical inspections and taking prompt action against defaulters.

(d) Maintaining year-wise data of legal/RRC cases to keep track of the status of each case and arrest delays in pursuance of legal/RRC cases.

(e) Exploring the possibility of enhancing the scope for initiating action for the recovery of dues under other Acts by getting itself notified as a public financial institution.

The Ministry stated (December 2004) that the review mentions about the various problems and shortcomings in sanction and disbursement of loans, their follow up and recoveries which pertained to the period prior to the assuming of office by the new management in July 2002. After the new management took office, there was complete review and revamping of the operations of the Company and system and procedures were tightened, security norms for financing strengthened and delegation of powers pruned down. As these measures have been taken during 2003-04 and 2004-05, the results of these will be known only in future.

MINISTRY OF TEXTILES

CHAPTER : XIV

National Textile Corporation (APKK&M) Limited

Sale of surplus Land and Buildings

Highlights

By not considering latest index formula of Income Tax department, government guidance rates and by applying unjustified deductions for various charges the Company worked out the reserve price as Rs.173.70 crore instead of Rs.279.89 crore as worked out in Audit. This resulted in lower fixation of reserve price by Rs.106.19 crore.

(Para 14.5.1)

According to the guidelines issued (August 2002) by National Textile Corporation Limited (Holding Company), reserve price was to be fixed at the highest of Registration/CBDT/CPWD or Registered Valuers' valuation. However, the Holding Company revised (December 2002) the method of computation of reserve price to 'average' of the three valuations. This resulted in fixation of lower reserve price by Rs.199.56 crore. On being pointed out in Audit, the Holding Company again changed the method of computation to highest valuation of the values.

(Para 14.5.2)

Due to fixation of lower reserve price by Rs.67.65 crore, one party managed to purchase 18.69 acres of land of Mysore Mills on single bid basis for Rs.79.16 crore only which was even below the Government guidance value as admitted by the purchaser himself. The Administrative Ministry had advised that Asset Sale Committee may sub-divide the land into plots urgently in case there were no bids (or satisfactory bids). This was not followed in case of Mysore Mills land where only one bid was received which was also not a satisfactory bid.

(Para 14.6.1)

Even though the purchasers had matched the reserve prices, the Company had foregone a potential revenue realisation of Rs.23.26 crore and Rs.5.50 crore in respect of Minerva Mills and Netha Mills respectively due to fixation of reserve price, on lower side.

(Para 14.6.2 and 14.6.3)

Non-consideration of remunerative offer from Karnataka Housing Board, Bangalore resulted in foregoing of opportunity to sell the surplus land for a higher consideration to the extent of Rs.55.61 crore.

(Para 14.7.1)

14.1 Introduction

The National Textile Corporation (APKK&M) Limited, Bangalore (Company) was set up in October 1974, on reorganisation of National Textile Corporation Limited, New Delhi (Holding Company) by transferring 16 mills located in Andhra Pradesh, Karnataka, Kerala and Mahe. These mills were nationalised under the provisions of Sick Textile

Undertakings (Nationalisation) Act, 1974. The Company, engaged in manufacture of yarn and cloth of cotton and polyester blended varieties, incurred losses since early 1980s. Consequent on its networth becoming negative, it was referred (1992) to the Board for Industrial and Financial Reconstruction (BIFR) and was declared a Sick Industrial Company on 12 January 1993. The Ministry of Textiles (MoT), Government of India, formulated a revival strategy based on which a revival scheme proposed (July 2001) by the IFCI (Operating Agency) was sanctioned by BIFR in March 2002 for implementation.

The approved BIFR scheme *inter alia* envisaged income of Rs.314.04 crore on sale of 744.70 acres of surplus land and buildings by 2003-04 through an Asset Sale Committee (ASC) to be constituted by the Holding Company. The Company sold 55.70 acres of land of three mills (18.69 acres of Mysore Mills, 9.83 acres of Netha Mills and 27.18 acres of Minerva Mills) during January to September 2004.

14.2 Scope of the Review

The review examines the method adopted by the Company for valuation and fixation of reserve price and the tendering process in the sale of land and building with particular reference to sale of surplus land and buildings belonging to three mills, viz. Mysore Spinning & Manufacturing Mills (Mysore Mills), Bangalore; Minerva Mills, Bangalore and Netha Spinning Mills (Netha Mills), Secunderabad.

14.3 Asset Sale Committee (ASC)

As per the directions of the Ministry of Textiles (MoT) (November 2001), the Company constituted (June 2002) an Asset Sale Committee (ASC) for sale of surplus assets, with the Chairman and Managing Director (CMD) of the Holding Company as Chairman and CMD of the Company as Member Secretary. The representatives of MoT, Operating Agency, respective State Governments and a Special Director of BIFR were the other members of the ASC.

The ASC was entrusted with the responsibility of formulating necessary guidelines for disposal of the assets to ensure that

(i) the land was sold in such a manner as to generate maximum resources for the revival plan;

(ii) the sale was conducted in a transparent and fair manner and through open notifications; and

(iii) the procedures for sale and maintenance of accounts were as per highest professional standards and by engaging professional agencies for specific periods.

As the ASC had to ensure the sale in a transparent and fair manner and through open notifications, notice inviting bids for sale of land in Bangalore and Hyderabad should have been through global tenders by giving wide publicity. The Company did not go for global tendering which resulted in limited response and the Company could not get the advantage of competitive rates.

The Management stated (September 2004) that the Company could not go for global tendering process as it was not in the scheme for disposal of assets in any of the mills and in fact had notified the sale of land to major IT companies, which had given negative response or not responded at all to the offer. The reply is not tenable as the fact remains

that the Company had not gone for global tendering due to which the Company could not receive competitive rates for land at Bangalore and Hyderabad.

The succeeding paragraph indicates that the land was undervalued by the Company, was sold at low rates due to fixation of low reserve price and 18.69 acres of land of Mysore Mills was sold on the basis of single bid without having competitive rates.

14.4 Valuation

For the purpose of valuation of land, the Holding Company directed (December 2002) that the reserve price be determined on the basis of average of three values i.e., valuation of Central Board of Direct Taxes (CBDT), valuation under Draft Revival Scheme (DRS) and Registered Valuers' Valuation. Accordingly the Company fixed the reserve price as the average of these three values. The deficiencies noticed in audit on valuations are discussed in subsequent paragraphs.

14.4.1 CBDT Valuation

CBDT valuation of land done in 1994-95 was updated to 2001-02 by the Company by applying index formula of Income Tax Department. The same was not updated to March 2003 even though the index formula for 2002-2003 was available at the time of tender advertisement (in April 2003 for Mysore Mills, in August 2003 for Netha Mills and in October 2003 for Minerva Mills). This resulted in under-valuation by Rs.52.77 crore (Rs.47.85 crore for Mysore Mills, Rs.4.13 crore for Minerva Mills and Rs.0.79 crore for Netha Mills).

14.4.2 DRS Valuation

The DRS valuation was based on State Government guidance rates relating to 1998-1999. The latest available rates of land effective from 1 August 2002 were not considered for the purpose of DRS valuation of Mysore Mills and Minerva Mills. The major portion of land belonging to Mysore Mills, situated in a prime locality, 'Sampige Main Road' of Bangalore and that of Minerva Mills, situated on Magadi Road of Bangalore, carrying higher rates as per the Government notification, were undervalued by applying the lower rates applicable for 'Malleswaram' and 'Gopalapura' in respect of land of Mysore Mills and Minerva mills respectively. However, in respect of Netha Mills, there was overvaluation by Rs.4.43 crore due to adoption of incorrect rates. This resulted in undervaluation by Rs.134.30 crore (Rs.80.44 crore for Mysore Mills, Rs.58.29 crore for Minerva Mills and Rs. (-) 4.43 crore for Netha Mills).

14.4.3 Valuation by Registered Valuer

The Registered Valuer, while valuing the land pertaining to Mysore Mills and Minerva Mills, allowed deductions to the extent of 25 per cent towards amenities and open spaces, Rs.175 per sq.meter towards earth filling charges for low-lying areas and Rs.225 per sq.meter towards land conversion charges from Industrial use to Commercial/Residential use. In respect of Netha mills, allowances given were to the extent of 40 per cent towards amenities and open spaces and Rs.70 per sq.meter towards land conversion charges. These deductions were not justified since the land put on sale was on 'as is where is' and 'as is what is' basis. These resulted in undervaluation by Registered Valuer to the extent of Rs.135.08 crore (Rs.76.39 crore in the case of Mysore Mills, Rs.32.69 crore for Minerva Mills and Rs.26.00 crore for Netha Mills).

14.4.4 The Management stated (September 2004) that:

(i) indexation was considered to bring CBDT value close to the year of valuation by the Property Consultants who relied upon market value as of 1 April 2002. Therefore, it would be proper to compare the 1 April 2002 rates of the valuers' report with the rate of CBDT valuation indexing as on 31 March 2002, instead of comparing with the CBDT rates indexed as on 31 March 2003.

(ii) the guidance rates advised by the State Government were for residential and commercial land and not for industrial land. The industrial rates were now being published since August 2004 which were generally about 50 per cent of residential rates. Thus the rates applied by the Company in DRS valuation were much higher and reasonable.

(iii) the land was not a developed one and it was a generally accepted principle to give allowance for setback area, development cost, profit margin etc. to arrive at the market price of the property and this was being followed by any valuation agency. Further, the land put on sale was all industrial land which required change of land use involving additional cost and time.

(iv) in respect of Minerva Mills, no portion of surplus land was situated on Magadi Road but was surrounded by Mysore deviation road and road to Rajajinagar, high school and play ground. Further, rates applicable for Gopalapura were to be applied as against Magadi Road rates applied by Audit.

The replies are not tenable as:

(i) the land was advertised for sale during April 2003/August 2003/October 2003 by which time the index formula for the year 2002-2003 was available and as a prudent measure, should have been taken into account for CBDT valuation.

(ii) the land of Mysore mills was situated in a centrally located commercially/ residentially viable locality of the city viz., Sampige Road, Malleswaram. Even the Registered Valuer, while valuing the property, applied the commercial rate only.

(iii) conversion charges for conversion of land to commercial use was to be waived by the State Government as per Sanctioned Scheme of BIFR and thus deduction in valuation on this account was unwarranted.

(iv) allowing the deductions on account of open space for amenities and earth-filling charges for low-lying area was against the spirit of offering the land on 'as is where is' and 'as is what is' basis.

(v) the Minerva Mills land faces the Magadi Road and, therefore, as a prudent measure, the rates applicable for Magadi Road should have been applied.

14.5 Fixation of reserve price

14.5.1 As per the Holding Company guidelines (December 2002), the reserve price was to be the average of the three valuations. By adopting the unrealistic methods of computing the three types of valuations (CBDT, DRS and Valuers' valuation) as mentioned in preceding paragraphs, the Company worked out the reserve price as Rs.84.35 crore (Mysore Mills), Rs.67.03 crore (Minerva Mills) and Rs.22.32 crore (Netha Mills) instead of average reserve price worked out in audit as Rs.152.00 crore, Rs.98.72

crore and Rs.29.17 crore respectively. Thus the reserve price fixed by the Company was lower by Rs.106.19 crore (Rs.67.65 crore in the case of Mysore Mills, Rs.31.69 crore in the case of Minerva Mills and Rs.6.85 crore in the case of Netha Mills).

14.5.2 The Holding Company had (August 2002) initially stipulated that the reserve price would be the highest of the valuations by Registration Department/CBDT/Central Public Works Department (CPWD) or Registered Valuers. Had the Company considered the above guidelines for fixation of reserve price i.e., highest of three valuation figures, the reserve price would have been Rs.186.19 crore for Mysore Mills, Rs.140.18 crore for Minerva Mills and Rs.46.89 crore for Netha Mills. Thus the reserve price fixed by the Company was lower by Rs.199.56 crore (Rs.101.84 crore – Mysore Mills, Rs.73.15 crore – Minerva Mills and Rs.24.57 crore – Netha Mills).

The Management stated (September 2004) that it had followed guidelines received from the Holding Company in averaging the three valuations and the ASC was informed about the components. The reply is not tenable as the three valuations varied widely and the average of three became unrelated to any of these three values. Further, ASC was not informed about the method of computation of each valuation figure.

The Management further stated (September 2004) that as a follow up to the audit comments and a review undertaken by the Company, a meeting of all the members of ASC was held at the Holding Company on 14 September 2004 which analysed the entire procedure being followed and a decision was taken to revise the formula as follows:

- NTC should have a panel of government-approved reputed registered valuers; NTC should get the property evaluated at least by three different valuers, discreetly i.e., each valuer should not know that another valuer is appointed for the same task, before going for sale and the highest of these three values should be fixed as reserve price for land.
- NTC should revise its format of advertising, (i) to include the strong points of land; (ii) inherent strengths should be highlighted in the advertisements; and (iii) should be handled in a more commercial manner.
- The sale of land is not a matter of administration and/or governance but a commercial deal and, therefore, the reserve price should not be indicated in the newspaper advertisement.

However, the fact remains that the Company incurred loss by fixing low reserve prices.

14.6 Tendering and Price Negotiation

14.6.1 Mysore Mills

The Company fixed the reserve price at Rs.84.35 crore for land of 18.69 acres relating to Mysore Mills. There was only one bid (19 May 2003) for 18.27 acres from M/s.Hamara Shelters Private Limited (HSPL). As the bid (Rs.13.62 crore) was far less than the reserve price (Rs.82.45 crore), HSPL was asked to revise its price bid and the revised price bid (Rs.46.19 crore) of 30 May 2003 was also less than the reserve price. During negotiation, HSPL refused (13 June 2003) to match the reserve price and ASC decided to re-tender. Before action on re-tendering was taken, HSPL agreed (16 June 2003) to match the reserve price for total land of 18.69 acres and submitted its second revised offer (17 July and 29 July 2003) with some deductions (Rs.5.19 crore) towards encroachments on two

parcels of land. The revised offers for Rs.79.16 crore were accepted (3 July 2003 and 2 August 2003) by the ASC.

Considering the fact that the purchaser had matched the reserve price, the lower fixation of reserve price of Rs.84.35 crore led to the Company suffering a loss of potential realization of Rs.67.65 crore.

Further, MoT had directed (March 2003) that in cases where there was no bid (or satisfactory bid) the land could be sub-divided into plots and sold but the Company did not take any action to sub-divide the land into plots even though a single unsatisfactory bid was received. The single bid should have been rejected and the Company should have reinvited the bids by giving wider publicity.

The Management stated (September 2004) that:

(i) Audit had assumed that the 18.27 acres situated on Sampige Main Road, which was not correct as on the basis of surrounding circumference, only 12126 Sq.meters (2.997 acres) of the land was situated on Sampige Road. Besides, the Stamp Duty paid was accepted by the authorities which indicated that the sale value was not less than the guidance rates. Further, the DRS value to be adopted for land measuring 18.27 acres worked out to Rs.70.99 crore only.

(ii) there were two valid bids and both bidders were given an opportunity to revise their offers.

(iii) as per directions, sub-division of plots could be resorted to only when there was no response for the tender notification.

(iv) the process of formation of lay-out and sub-division of plots was highly technical for which the Company did not have expertise.

(v) as the sanctioned scheme had to be implemented within two years, it was not found prudent to sub-divide land into plots.

(vi) it was felt that re-tendering would not have good response.

The replies are not tenable as:

(i) the entire stretch of 18.27 acres of land is a single continuous piece of prime land and applying the rates on the basis of circumference of area is not justified and it led to undervaluation. This is further corroborated by the fact that the purchaser, HSPL, had admitted (October 2003) that the purchase price was less than the existing Government guidance value.

(ii) for sale of 18.27 acres of land, there was only one bid and not two as contended by management which was also unsatisfactory as it was much below the reserve price.

(iii) the Company could have availed the services of the architects for formation of lay-out and for subdivision of plots as the Ministry had delegated (March 2003) the powers to the Company to appoint the architect(s) without going through the tender process.

(iv) subdivision of plots could be resorted to not only when no response to tender notification was received but also when no satisfactory bid was received.

(v) the sanctioned scheme, in any case, had not been implemented within the stipulated period and the Company had approached (December 2003) BIFR for extension of implementation period by another two years i.e., upto 2005-06. Hence, sufficient time was available to subdivide the land into plots.

14.6.2 Netha Mills

The land (9.8326 acres) and building (11191 Sq. meter) were advertised for sale in August 2003. The reserve price was fixed at Rs.23 crore (Rs.22.32 crore for land and Rs.68 lakh for building) which was lower by Rs.6.85 crore (Para 14.5.1) and the highest offer of Rs.24.35 crore received from M/s. Airforce Naval Housing Board, New Delhi, was accepted (October 2003) by ASC. Though the Company realised Rs.1.35 crore more than the reserve price, considering the short fixation of reserve price by Rs.6.85 crore there was short realisation of revenue by Rs.5.50 crore.

The Management stated (September 2004) that considering the three valuations, the sale value realised amounting to Rs.24 crore was still higher than the highest of the above three valuations of Rs.23.79 crore. The reply is not tenable as the Company had not considered adding back the unjustified deduction allowed in the Valuers' valuation while fixing the reserve price.

14.6.3 Minerva Mills

The Company advertised (October 2003) 28.616 acres (8 parcels) of land for sale. While the highest offers (three offers) for five parcels of land were above the reserve price, in respect of two parcels it was below the reserve price and there was no offer for one parcel. Offer for one parcel of land where it was above the reserve price was withdrawn (December 2003) and remaining offers for four parcels of land were accepted by ASC (December 2003). The offer for two parcels where it was below the reserve price was also accepted as the party agreed to match the offer to reserve price. The ASC also decided to re-tender the remaining two parcels.

The reserve price for 27.18 acres of land sold worked out to Rs.94.78 crore as computed in Audit, against which the Company realised Rs.71.52 crore only due to fixation of lower reserve price of Rs.63.67 crore. Thus the sales realisation of Rs.71.52 crore was short by Rs.23.26 crore as compared to reserve price of Rs.94.78 crore.

The Management in its reply (September 2004) stated that Audit had considered higher rates applicable to Magadi Road as against rates applicable to Gopalapura where the Mill was situated. Further, in comparison to three valuations viz., CBDT indexed to 2002-2003 as per Audit, DRS valuation as per 2002-2003 applying Gopalapura rate and Valuers' valuation after deducting development cost, the sale value realised was higher. The reply is not tenable in view of the fact that the Company had considered Gopalapura rate instead of Magadi Road rate though the land faces Magadi Road and had not added back the development cost (Rs.31.05 crore) to the Valuers' valuation.

14.7 Other points of interest

14.7.1 Offer of Karnataka Housing Board (KHB)

Karnataka Housing Board (KHB) had evinced interest (February 2003) in purchasing 17 acres of land of Mysore Mills and 11 acres of Minerva Mills and requested the Company to consider giving the land at guidance value or the rate fixed by the Deputy Commissioner, Bangalore. Further, KHB requested for fixing the price for 50 per cent of

the area at half of the rate for other areas since KHB had to earmark 50 per cent of space for civic amenities and open spaces. The Company, however, informed (February 2003) KHB that as the State Government guidance rates were far below the valuation rate of registered valuers, it was not possible to allot the land at guidance rates. If the Company had allotted the land to KHB at State Government notified rates even by charging half the price for 50 per cent of the area, it would have realised Rs.116.59 crore in respect of 17 acres of Mysore Mills land and Rs.45.73 crore in respect of 11 acres of Minerva Mills land. But the Company realised (January, May and September 2004) only Rs.73.08 crore and Rs.33.63 crore respectively. Calculated on this basis the short-realisation was Rs.55.61 crore.

The Management stated (September 2004) that:

(i) KHB's letter was received during February 2003, whereas the advertisement was published in April 2003. If they were really interested they could have responded to the advertisement and participated in the tender process.

(ii) KHB had requested for fixation of price on acreage basis and not on sq.foot basis. Further, in a wholesale market, rates were much lower than the retail market. Thus considering 50 per cent of the guidance rates, the value of Mysore Mills land if allotted to KHB worked out to Rs.58.29 crore only and the value of Minerva Mills land worked out to Rs.11.43 crore considering Gopalapura rates against Magadi road rate considered by Audit. As against this the Company had received Rs.73.08 crore in respect of Mysore mills and Rs.33.63 crore in respect of Minerva mills in open tender process without any loss of revenue.

The reply of the management is an afterthought as the Company had not made any negotiation with KHB regarding valuation of the land.

14.8 Conclusions

- Due to not considering the current index formula of 2002-03, Government guidance rates effective from 1 August 2002 and allowing unjustified deductions on account of development cost, even the average reserve price was not computed properly by the Company. This resulted in foregoing of potential revenue realisation of Rs.96.41 crore (Rs.67.65 crore in Mysore Mills, Rs.5.50 crore in Netha Mills and Rs.23.26 crore in Minerva Mills).
- The Company had not gone in for global tendering for sale of land due to which limited response was received.
- The ASC did not follow the Ministry's guidelines to sub-divide the land into plots in case of unsatisfactory bids.
- Due to undervaluation of reserve price by Rs.67.65 crore, 18.69 acres of land of Mysore Mills was sold to one party on single bid basis for Rs.79.16 crore which was even below the Government guidance value as admitted by the purchaser.
- Non-consideration of the offers of KHB resulted in foregoing an opportunity to sell the surplus land at a higher consideration by Rs.55.61 crore (Rs.43.51 crore in Mysore Mills and Rs.12.10 crore in Minerva Mills).

14.9 Recommendations

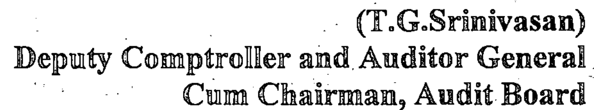
(i) The Company should fix the reserve price of the land taking all factors into account, including current market valuation, so that its financial interest would be protected.

(ii) In case of single and/or unsatisfactory bids, the land should be sub-divided into plots as per MoT's guidelines (March 2003). The process of re-tendering may also be followed in such circumstances.

(iii) To ensure fair and competitive rates, wide publicity should be made through invitation of Global Tender.

(iv) In case of sale of 18.69 acres of Mysore Mills land to HSPL, the matter may be investigated to find out the reasons for sale below the Government guidance rates.

The review was issued to the Ministry in October 2004; its reply was awaited (March 2005).



(T.G.Srinivasan)
Deputy Comptroller and Auditor General
Cum Chairman, Audit Board

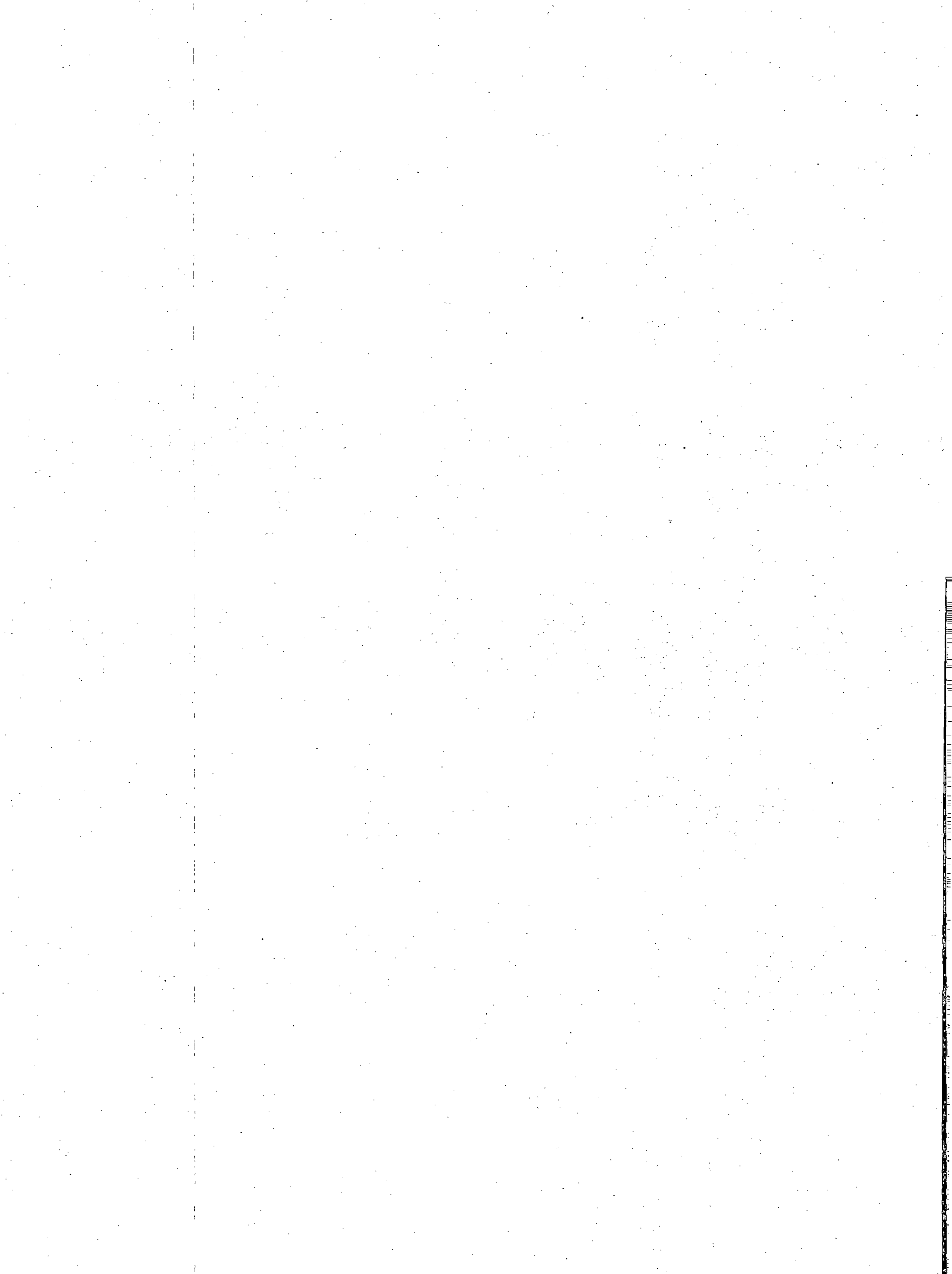
New Delhi
Dated 20 April 2005

Countersigned

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

New Delhi
Dated 25 April 2005

ANNEXURES



Annexure-1
(Referred to in para 1.3)

Profit & Loss Account Of HOCL for the last five years **(Rs. in crore)**

Particulars	1999-00			2000-01			2001-02			2002-03			2003-04		
	RSN	Kochin	Total	RSN	Kochin	Total	RSN	Kochin	Total	RSN	Kochin	Total	RSN	Kochin	Total
INCOME															
Sales (gross)	182.68	227.41	410.09	96.10	311.29	407.39	112.72	188.24	300.96	139.81	327.40	467.21	150.84	333.73	484.57
Less Excise duty	0	0	0	0	0	0	0	0	0	20.56	46.61	67.17	22.36	47.45	69.81
Net Sales	182.68	227.41	410.09	96.10	311.29	407.39	112.72	188.24	300.96	119.25	280.79	400.04	128.48	286.28	414.76
Sale of Trading Goods	10.89	0.20	11.09	0.48	0	0.48	0.08	0	0.08	0.24	0	0.24	0.03	0	0.03
Other Income	7.38	2.61	9.99	8.96	2.88	11.84	6.10	2.09	8.19	6.70	2.44	9.14	4.60	3.32	7.92
Profit on sale of Assets	0	0	0	0.43	0	0.43	0.10	0	0.10	0.05	0	0.05	0.02	0	0.02
Increase (decrease) in Stock in Trade and in Process	-20.74	0.05	-20.69	-0.60	5.85	5.25	-3.64	-7.74	-11.38	0.78	1.50	2.28	1.34	1.64	1.78
Total	180.21	230.27	410.48	105.37	320.02	425.39	115.36	182.59	297.95	127.02	284.73	411.75	134.47	306.07	440.54
EXPENDITURE															0
Material Consumed	96.13	103.31	199.44	58.94	135.14	194.08	56.38	89.63	146.01	83.88	141.88	225.76	100.17	167.33	267.50
Excise duty	28.01	33.50	61.51	13.75	44.90	58.65	15.65	26.14	41.79	0.16	0.85	1.01	0.10	1.64	1.73
Purchase ofTrading Goods	10.50	0.15	10.65	0.47	0	0.47	0.06	0	0.06	0.67	0	0.67	0.05	0	0.05
Employees' Remuneration and Benefits	37.42	11.86	49.28	34.16	12.14	46.30	33.35	14.57	47.92	35.56	15.43	50.99	36.82	16.30	53.12
Manufacturing Admn. &Selling Expenditure	47.56	44.63	92.19	26.25	54.12	80.37	25.71	46.49	72.20	27.26	67.30	94.56	28.89	67.27	96.16
Total	219.62	193.45	413.07	133.57	246.30	379.87	131.15	176.83	307.98	147.53	225.46	372.99	166.03	252.54	418.56
Operating Profit /Loss	-39.41	36.82	-2.59	-28.20	73.72	45.52	-15.79	5.76	-10.03	-20.51	59.27	38.76	-31.56	53.53	21.98
Interest	27.94	19.00	46.94	28.21	20.99	49.20	27.65	18.37	46.02	28.18	17.00	45.18	24.19	13.71	37.90
Cash Profit /Loss	-67.35	17.82	-49.53	-56.41	52.73	-3.68	-43.44	-12.61	-56.05	-48.69	42.27	-6.42	-55.75	39.82	-15.92
Depreciation	18.14	10.28	28.42	17.92	10.54	28.46	17.89	10.39	28.28	17.59	10.57	28.16	17.47	10.63	28.10
Provisions	16.39	0.36	16.75	4.32	0.19	4.51	5.37	1.77	7.14	4.77	2.05	6.82	66.59	5.47	72.06
Loss on sale/disposal of Assets	0	0	0	0.80	0	0.80	0	0	0	0.10	0.03	0.13	0.20	0	0.20
	34.53	1064	45.17	23.04	10.73	33.77	23.26	12.16	35.42	22.46	12.65	35.11	84.26	16.10	100.36
Profit(loss) for the year before Tax	-101.88	7..18	-94.70	-79.45	42.00	-37.45	-66.70	-24.77	-91.47	-71.15	29.62	-41.53	-140.01	23.72	-116.28

RSN: Rasayani Unit

Annexure-2

(Referred to in Para 5.6.4)

Case studies of doubtful export transactions in foodgrains

CS No	Subject	Case Study
1	Date of Export prior to the date of issue of foodgrains by FCI Exported rice not according to the specification of rice procured by FCI.	M/s.Kanthilal & Co. lifted 2249.489 MTs of boiled rice on 3, 4, 5, 6 and 7 of December 2001 and submitted the Bill of Lading dated 5 December 2001 whereas the District Office, FCI, Tuticorin had issued only 1383.822 MT as on that date. The same party lifted a quantity of 1479.965 MT of boiled rice on 22 and 24 of December 2001 against another allotment. The party submitted Bills of Lading for the entire quantity. The commodity indicated in the Bill of Lading was Indian long grain par-boiled rice of 20 per cent broken, whereas the maximum broken percentage as per FCI specification was only 16. Further, the clause indicating "Non-basmathi/non-scented rice" was incorporated in the Bill of Lading by way of subsequent corrections. In spite of these anomalies, FCI released the Bank Guarantee submitted by the party, which resulted in undue benefit of Rs.1.31 crore being the difference between the Open Sale rate and concessional export rate on the total quantity of 3729.454 MT to the party.
2	Bills of lading three months later than the shipping bill date. Substitution of documents. Forged documents Reimbursement of transport charges without proof of truck chits for goods having been delivered in Port	PEC in association with M/s.Shiv Nath Rai Harnarain (India) Ltd., New Delhi lifted 10,275.864 MTs of boiled rice from District Office, Raichur (Karnataka) during the period from April 2002 to June 2002 and submitted export documents for 7543.570 MTs (Nil per cent brokens). The Bills of Lading were dated August 2002. The shipping bills furnished by the exporters indicated that the same were submitted to the customs authorities in May 2002 itself. The state of origin of goods was mentioned as Delhi. As the copies of the shipping bills submitted by the party were not legible, FCI called for clear copies. The party responded in December 2002 with the shipping bills in which the reverse sides were not the same as submitted earlier. Moreover, the shipping bill number which was hand-written in the bills submitted originally was machine numbered while submitting later. The party did not submit the truck chits in proof of movement of stocks to the port towns. In spite of these glaring inconsistencies in the documents, the case was not investigated to ensure the genuineness of the export. Therefore, the concession of Rs.3.60 crore granted by the Corporation was irregular.
3	Export concession granted based on false Chartered Accountant's certificate	District Offices, Rajkot and Sabarmathi (Gujarat) issued 2450 MT of raw rice during August 2002 to M/s.Algyas for export purposes. The party submitted export documents for 1796 MT along with the Chartered Accountant certificate dated 12 October 2002 claiming that 605 MT was sold as brokens and rejections in domestic market to M/s.Ashok Kumar and Aman Kumar. The balance 49 MT was claimed to be transit and processing shortages. However, when it was pointed out to the party that they were not eligible for any concession towards brokens in view of the withdrawal of the concession by the Government, the exporters submitted another certificate dated 4 October 2002 (i.e., prior to the earlier certificate) from the same Chartered Accountant stating that 2408 MT of rice was exported. This was irregular and could not be accepted. Therefore, an amount of Rs.23 lakh was recoverable towards the differential cost for 605 MT of raw rice.
4	Export documents not corresponding to the rice lifted from FCI	PEC Ltd., New Delhi in association with Shivnath Rai Harnarain(India) Ltd., lifted 27,724.229 MT in November 2002, December 2002 and February 2003 from FCI Andhra Pradesh region for export to Nigeria. Out of the quantity lifted, the party exported 27,188.854 MT during December 2002 to June 2003 and balance quantity was claimed as operational loss as detailed below:

<table>
<tr>
<td></td>
<td>Export documents not corresponding to the export contract for which intended.</td>
<td>
In MT
<table>
<tr><th>S.No</th><th>Quantity lifted</th><th>Quantity exported</th><th>Operational</th></tr>
<tr><td>1</td><td>2310.677</td><td>2264.463</td><td>46.214</td></tr>
<tr><td>1</td><td>6928.000</td><td>6805.650</td><td>122.350</td></tr>
<tr><td>3</td><td>18485.622</td><td>18118.741</td><td>366.881</td></tr>
<tr><td>Total</td><td>27724.299</td><td>27188.854</td><td>535.445</td></tr>
</table>
From a review of the export documents submitted by the party, it was observed that the party claimed to have exported 5042.749 MT parboiled rice PR-106 out of the stocks lifted from FCI, Andhra Pradesh. However, PR-106 variety was not procured in Andhra Pradesh. Thus, 5042.749 MT exported was not the stock lifted from FCI. Out of the total exports, 7188.855 MT was exported to other countries. As per the sale contracts, brokens was 0 to 5 per cent. However, boiled rice up to 10 per cent brokens was exported. The Regional Vigilance Squad which investigated the transactions recommended to treat the issues as local sales and to recover differential cost of Rs.8.73 crore along with freight, market fee and sales tax amounting to Rs.4.57 crore from the party. However, no recovery was made from the party.
</td>
</tr>
<tr>
<td>5</td>
<td>Export documents not pertain to rice lifted from FCI's stocks</td>
<td>M/s. Sam Enterprises lifted (August 2002) 2032 MT of Punjab raw rice from Bangalore. The bills of lading, shipping bills and invoices submitted by the party however indicated that the rice was of Andhra Pradesh origin. Hence, the rice exported could not be construed as rice lifted from FCI. The differential cost recoverable from the party was Rs.73 lakh.</td>
</tr>
<tr>
<td>6</td>
<td>Export concessions granted for stock not lifted from FCI</td>
<td>PEC submitted export documents dated 23 September 2002 towards 13466 MT of Lustre lost wheat lifted from District Office, FCI, Gandhidham (Gujarat) and Shivpuri (Madhya Pradesh) during October 2002. It was stated by the party that the stocks were taken on loan from MARKFED (Punjab) and the stocks lifted from FCI godowns in October 2002 were returned to MARKFED.

Similarly, the STC lifted 2350 MT of wheat for export from District Office, FCI, Baroda (Gujarat) during the period from 15 January 2001 to 16 January 2001. The stocks were moved by rail to Gandhidham port on 16 January 2001. The party submitted Bill of Lading dated 16 January 2001 i.e., when the stocks were actually on transit to Gandhidham. Subsequently (September 2003), the STC clarified that the shipment was made by taking loan from sister Public Sector Undertaking and the stocks purchased from FCI was utilized to replenish the stocks obtained on loan.

The substitution was against the instructions of the Government.

As the exporter was required to export the same rice issued by FCI, the documents submitted by the party should not have been accepted towards discharge of export obligation. The differential price recoverable from the parties towards the above was Rs.4.52 crore. (PEC: Rs3.84 crore /STC: Rs.68 lakh)</td>
</tr>
<tr>
<td>7</td>
<td>Export concession extended for feed wheat which was not issued by FCI for exports</td>
<td>The PEC lifted 14396 MT of sound wheat from District Office, FCI, Gandhidham and Rajkot (Gujarat) during the period from May 2002 to July 2002. The bills of lading and shipping bills submitted by the party against the above issues indicated that the wheat actually exported was "Feed Wheat". As the wheat issued by FCI was not feed wheat, the export of feed wheat should not have been accepted. The differential price recoverable from the party work out to Rs.3.87 crore.</td>
</tr>
<tr>
<td>8</td>
<td>Export concession granted for rice not exported</td>
<td>A quantity of 15547 MT of wheat issued by FCI to PEC was reportedly damaged at the custody of PEC. Hence the stocks were not exported by the party. However, the differential cost of Rs.4.80 crore towards the unexported quantity was not recovered from the PEC.</td>
</tr>
</table>

Annexure – 3

(Referred to in Para 6.4.1)

Statement indicating capacity utilisation in terms of SMH for the Company as a whole

Particulars	1999-00	2000-01	2001-02	2002-03	2003-04
1. Available SMH (in lakh hours)	35.54	33.32	27.73	26.63	31.71
2. Utilisation (in lakh hours)	30.36	31.20	28.06	27.56	40.29
3. Percentage of utilisation to available SMH (Sl. No.2/Sl. No.1)	85.42	93.64	101.18	103.49	127.06
4.Direct labour (Nos) – (Assembly and Fabrication)	3000	2813	2341	2248	2676
5. SMH output per direct labour (Hours per year) Sl No.2/Sl No.4	1012	1109	1199	1226	1505

Annexure – 4
(Referred to in Para 6.4.4)

Unitwise details of Non-moving (NM) and Slow-moving (SM) inventory

(Rs. in crore)

	1999-2000			2000-01			2001-02			2002-03			2003-04		
Unit	NM	SM	*	NM	SM	*	NM	SM	*	NM	SM	*	NM	SM	*
Bangalore Complex	31.67	47.68	19	47.66	60.89	20	37.52	26.85	11	50.29	24.78	13	61.27	25.36	15
Ghaziabad	21.10	6.27	32	19.05	6.53	29	18.67	8.45	28	16.25	0.32	15	30.67	9.05	32
Hyderabad	5.67	4.18	20	9.29	4.86	27	9.29	4.86	18	0.00	5.75	5	11.76	5.75	11
Pune	0.05	0.03	1	0.00	0.00	0	0.00	0.00	0	0.00	0.00	0	0.29	-	1
Machili-patnam	0.15	0.43	14	0.27	0.90	15	0.27	0.90	6	0.00	2.23	4	1.13	2.17	19
Kotdwara	0.12	-	1	0.11	-	-	0.30	-	1	0.59	2.06	8	0.44	0.82	2
Chennai	0.25	0.80	7	0.61	2.42	18	0.35	3.03	18	0.00	1.80	11	1.92	3.09	24
Panchkula	1.60	0.55	4	1.05	1.05	3	0.72	-	1	0.66	0.00	2	1.62	-	5
Taloja	0.00	0.00	0	0.00	0.00	0	0.00	0.00	0	0.00	0.92	17	0.02	-	0
Total	**60.61**	**59.94**	**18**	**78.04**	**76.65**	**18**	**67.12**	**44.09**	**12**	**67.79**	**37.86**	**11**	**109.13**	**46.24**	**15**

* Percentage to total inventory

Annexure-5
(Referred to in Para 7.4.3)

(1) In respect finished goods stock of DCS(T) Division, out of 27 items selected (Unit rate > Rs.1000 considered) from MRP-II system, four items were matching with the IFAS data. In respect of remaining 23 items though there was a balance quantity in MRP-II, the same was not appearing in IFAS stock data. The value of discrepancy amounted to Rs.111.36 lakh. A few illustrations are given below:

Part No.	Quantity as per MRP-II	Quantity as per IFAS	Discrepancy in quantity	Value of discrepancy (Rs. in lakh)
110000909030	105	0	105	32.55
110001043375	210	0	210	12.98
116000965086	6	0	6	6.00

(2) In respect of stock of BTV Division, out of 22 items selected (Unit rate > Rs.50,000 considered) from MRP-II system, 21 items had balance quantity as per MRP-II, but these items were not appearing in the IFAS. Further, in respect of one item as against the balance quantity of 75 Nos. in MRP-II, the quantity as IFAS was one having a difference of 74 Nos. (Rs.68.09 lakh) The discrepancy amounted to Rs.4032.40 lakh. A few illustrations are given below:

Part No.	Quantity as per MRP-II	Quantity as per IFAS	Discrepancy in quantity	Value of discrepancy (Rs. in lakh)
476611590156	75	1	74	68.09
900011977127	62	0	62	258.11
4766149800112	3	0	3	1062.65
900011684769	1	0	1	102.41

(3) In respect of FG stock of DCS-M Division, out of 17 items selected (Unit rate >Rs.1 lakh considered) from MRP-II there existed discrepancy in respect of three items and no discrepancy in respect of one item when compared to IFAS data. Besides, 13 items in respect of which balance quantity was present in the MRP-II data, the items did not appear in the IFAS data. The discrepancy amounted to Rs.1699.43 lakh. Illustrative cases are given below:

Part No.	Qty. as per MRP-II	Quantity as per IFAS	Discrepancy in quantity	Value of discrepancy (Rs. in lakh)
110001051038	91	1	90	335.34
100002910092	19	6	13	15.99
112001850056	8	0	8	1128.00
114000220097	10	0	10	36.00

(4) In respect of FG stock of LPE Division, out of nine items selected (Unit rate >Rs.1 lakh considered), from MRP-II only one item's quantity was matching with IFAS data and though there was balance in MRP-II data, eight other items were not appearing in IFAS. The discrepancy amounted to Rs.343.94 lakh. A few illustrations are given bellow:

Part No.	Quantity as per MRP-II	Quantity as per IFAS	Discrepancy in quantity	Value of discrepancy (Rs. in lakh)
ROD90809	19	0	19	67.91
ROD908135	19	0	19	53.44
ROD90806/8	19	0	19	55.88
ROA11977136	10	0	10	18.15

(5) In respect of FG stock of High Frequency Division, out of four items selected (Unit rate >Rs.50,000 considered), there was no difference in respect of one item and three items, though appearing in MRP-II, were not found in stock data of IFAS. The discrepancy amounted to Rs.231.75 lakh. The details are given below:

Part No.	Qty. as per MRP-II	Quantity as per IFAS	Discrepancy in quantity	Value of discrepancy (Rs. in lakh)
110001593850	3	0	3	201.08
116001100110	3	0	3	28.79
110001275108	1	0	1	1.88

(6) In respect of Radar Division, out of 11 FG items selected (Unit rate >Rs. 50,000 considered), seven items though appearing in MRP-II were not figuring in IFAS data. Three items though appearing in IFAS were not figuring in MRP-II data. Even though one item appeared in both the data there was a difference in the quantity between the two systems. The discrepancy amounted to Rs.28.02 lakh. A few illustrations are given below:

Part No.	Qty. as per MRP-II	Quantity as per IFAS	Discrepancy in quantity	Value of discrepancy (Rs. in lakh)
112002744202	1	0	1	2.58
212114860192	3	0	3	2.74
HN089490	7	0	7	3.78
R41684	7	0	7	9.76

(7) In respect of BTV Division, out of 17 raw material items selected (Unit rate >Rs.10,000 considered) from MRP-II data, there was no difference between the two systems for 13 items. However, though there was stock quantity in MRP-II relating to

four items the IFAS was not showing the items in the data. The discrepancy amounted to Rs.105.31 lakh as detailed below:

Part No.	Qty. as per MRP-II	Quantity as per IFAS	Discrepancy in quantity	Value of discrepancy (Rs. in lakh)
900011970531	3	0	3	79.24
900011817174	75	0	75	13.09
900011960540	12	0	12	7.80
900011958794	4	0	4	5.18

(8) In respect of DCS(T) Division, out of 26 raw material items selected (Unit rate >Rs.100 considered) from MRP-II only 15 items appeared in IFAS. Out of 15 items there was no difference in respect of eight items and in respect of seven items the quantity was more in IFAS compared to MRP-II. Further, in respect of four items the data in MRP-II did not show unit rate and value whereas IFAS data showed rate and value. The discrepancy value amounted to Rs.0.80 lakh. A few illustrations are given below:

Part No.	Qty. as per MRP-II	Quantity as per IFAS	Discrepancy in quantity	Value of discrepancy (Rs. in lakh)
436310730205	8	93	85	0.23
437010110196	8	18	10	0.15
437010670177	8	17	9	0.09
437812820116	4	11	7	0.19

(9) In respect of HF Division, out of 32 raw material items selected (Unit rate >Rs.50,000 considered) there was discrepancy in quantity in respect of MRP-II and IFAS data in respect of only two items. The discrepancy value amounted to Rs.198.21 lakh. The details are given below:

Part No.	Qty. as per MRP-II	Quantity as per IFAS	Discrepancy in quantity	Value of discrepancy (Rs. in lakh)
455610520184	55	51	4	191.09
455610530175	6	2	4	7.12

(10) In respect of LPE Division, out of 30 items of raw material selected (Unit rate >Rs.30,000 considered) two items appearing in MRP-II data did not appear in IFAS data. The value of discrepancy amounted to Rs.1.11 lakh. Instances are given below:

Part No.	Qty. as per MRP-II	Quantity as per IFAS	Discrepancy in quantity	Value of discrepancy (Rs. in lakh)
991910321006	1	0	1	0.42
476610860134	2	0	2	0.69

(11) In respect of Radar Division, out of 47 raw material items selected (Unit rate >Rs.1 lakh considered) from MRP-II data there was discrepancy in quantity relating

to four items. The value of discrepancy amounted to Rs.22.21 lakh. Details are given below:

Part No.	Qty. as per MRP-II	Quantity as per IFAS	Discrepancy in quantity	Value of discrepancy (Rs. in lakh)
112001470592	1	2	1	2.65
418810290129	10	11	1	3.66
474111140161	1	3	2	4.19
515010250134	4.5 kg.	0.45 kg.	4.05 Kg.	11.71

Annexure –6

(Referred to in Para 8.4.4)

Vessels completed during the years 1998-99 to 2003-04 and Profit and Loss made thereon

(Rs. in crore)

Sl. No.	Type of Vessel	Yard No.	Keel Laid on	Launched on	Contracted delivery date	Delivered on	Final Contract price (Sale)	Actual cost	Profit/ (Loss)	Delay in months	Type of Contract
A. INDIAN NAVY VESSELS											
1.	Fleet Replenishment Tanker	3008	25.08.88	15.11.93	Dec, 91	21.03.2K	245.00	271.30	(26.30)	99	Fixed
2.	Frigate	3009	30.12.88	29.01.94	Dec, 95	31.03.2K	697.64	648.97	48.67	51	Cost Plus
3.	Missile Corvette	2039	10.01.90	10.10.92	March, 92	10.08.98	269.92	251.09	18.83	65	Cost Plus
4.	Missile Corvette	2041	16.10.95	18.08.97	March, 93	14.08.01	309.63	288.03	21.06	101	Cost Plus
5.	Missile Corvette	2042	30.08.97	06.04.2K	Sep, 93	30.01.04	312.83	291.00	21.83	125	Cost Plus
6.	Fast Attack Craft	2047	22.04.97	21.09.98	Nov, 97	11.09.2K	41.04	40.63	0.41	34	Fixed
7.	Fast Attack Craft	2048	20.01.98	17.02.99	May, 98	27.02.01	41.01	40.01	1.00	33	Fixed
8.	Fast Attack Craft	2049	12.10.98	10.11.99	Nov, 98	31.07.01	41.01	40.63	0.38	34	Fixed
9.	Fast Attack Craft	2050	05.05.99	05.05.2K	May, 99	15.01.02	41.05	39.92	1.13	32	Fixed
B. COAST GUARD VESSELS											
1.	Hovercraft	1121	N.A.	N.A.	01.08.2K	29.08.2K	8.24	9.34	(1.1)	1	Fixed
2.	Hovercraft	1122	N.A.	N.A.	01.10.2K	23.04.01	8.28	8.51	(0.23)	6	Fixed
3.	Hovercraft	1123	N.A.	N.A.	01.02.01	27.07.01	8.20	8.04	0.16	5	Fixed
4.	Hovercraft	1124	N.A.	N.A.	01.06.01	19.10.01	8.20	8.11	0.09	4	Fixed
5.	Hovercraft	1125	N.A.	N.A.	01.10.01	05.11.01	8.20	9.03	(0.83)	1	Fixed
6.	Hovercraft	1126	N.A.	N.A.	01.02.02	12.03.02	8.20	7.87	0.33	1	Fixed

Annexure - 7
(Referred to in Para 13.4)
FINANCIAL POSITION

The table below summarises the financial position of the Company for the five years period ending 31 March 2004.

(Rupees in crore)

Liabilities	1999-2000	2000-2001	2001-2002	2002-2003	2003-2004
a) Paid up capital i)Government ii)Others	167.99	167.99	167.99	167.99	187.99
b) Reserves & Surplus	13.92	9.06	8.72	7.85	7.23
c) Borrowings (i)Government of India (ii)Other financial institutions (iii)Foreign currency loan (iv)Others including cash credit and interest accrued and due	0.26 37.98 43.21 212.11	0.13 48.48 42.12 128.28	0.03 45.47 43.56 85.20	0.01 25.48 54.23 77.52	- - 57.55 68.84
d) Current liabilities and provisions	82.46	81.52	72.15	62.87	62.79
Total	557.93	477.59	423.12	395.95	384.40
Assets					
e) Gross Block	71.14	66.51	68.55	64.53	60.83
f) Less Depreciation	40.77	39.40	39.70	39.11	37.72
g) Net Block	30.37	27.11	28.85	25.42	23.11
h) Capital work-in-progress	2.61	5.40	0.07	0.08	-
I)Investments	1.30	1.30	1.30	1.30	1.30
j)Current Assets & Loans and Advances	523.64	396.55	261.55	224.85	216.46
k)Misc.Expenditure	0.01	0.01	0.01	0.01	0.01
l) Accumulated losses	-	47.22	131.34	144.29	143.52
TOTAL	557.93	477.59	423.12	395.95	384.40
Capital Employed	472.15	347.61	224.24	193.82	183.69
Net Worth	173.23	120.76	36.64	23.69	44.46
Net Worth per rupee of Paid up Capital	1.03	0.72	0.22	0.14	0.24

Annexure 8
(Referred to in para 13.4)
Working Results

Statement showing the working results for five years ending 31 March 2004.

(Rupees in crore)

Particulars	1999-2000	2000-2001	2001-2002	2002-2003	2003-2004
A.Income					
1.Sales	110.25	190.13	185.10	170.44	148.09
2.Hire charges	3.15	4.60	5.07	5.23	4.34
3.Lease rentals	5.62	4.39	2.87	1.92	1.43
4.Grants and subsidies	15.89	15.41	20.68	20.80	15.75
5.Interest	19.67	17.08	12.99	9.37	7.59
6.Other income	28.94	19.00	17.06	18.15	°28.26
7.Misc.	10.80	12.27	4.75	3.62	3.00
Total	**194.32**	**262.88**	**248.52**	**229.53**	**208.46**
B.Expenditure					
1.Purchases	105.58	186.20	182.62	168.33	146.35
2.Consumption of stores	2.21	1.75	0.98	0.22	0.10
3.Acc.dec. in stock	0.07	1.35	0.14	0.39	0.29
4.Employees salaries	23.52	23.96	29.00	30.32	21.35
5.Depreciation	3.72	3.70	2.87	2.25	1.91
6.Interest	27.87	24.22	20.32	18.48	12.10
7.Other expenses	16.51	18.00	16.70	18.77	22.43
8.Bad debts written off	4.43	1.96	1.36	0.61	0.93
9.Exchange variation losses	2.23	1.85	2.92	1.45	0.48
10.Deprcn.as per contra	0.68	0.75	0.78	0.76	0.72
11.Prov.for Bad and Doubtful debts	0.55	42.79	70.95	0.00	0.00
12.Other provisions	1.40	3.12	0.26	0.31	0.32
13.Total	**188.77**	**309.65**	**328.90**	**241.89**	**206.98**
14.Net Profit/Loss	**5.55**	**(-)46.77**	**(-)80.38**	**(-)12.36**	**1.48**

° *includes Rs.12.19 crore provision written back.*

Annexure-9
(Referred to in para 13.4)
Performance of financing activities

(Rupees in crore)

Particulars	1999-2000	2000-01	2001-02	2002-03	2003-04
Income					
Sales	106.40	187.13	182.87	168.73	146.59
Hire-charges	3.15	4.60	5.07	5.23	4.34
Lease rentals	5.62	4.39	2.87	1.92	1.43
Service charges	6.08	4.99	3.94	2.85	2.24
Interest	19.56	16.94	12.83	9.18	7.43
Other income	24.88	14.38	12.37	12.59	7.96
Grants/subsidies	2.95	2.38	4.88	5.95	1.24
Total	**168.64**	**234.81**	**224.83**	**206.45**	**171.23**
Expenditure					
Purchase	105.58	186.20	182.55	168.33	146.31
Financial charges	27.85	24.20	20.32	18.48	12.09
Employee cost	11.42	10.29	15.90	16.90	10.44
Depreciation	3.58	3.50	2.66	2.02	1.66
Provision for Bad & Doubtful debts	0.55	42.79	70.87	-	-
Bad debts written off	4.43	1.96	1.31	0.60	0.93
Others	9.68	12.67	16.98	12.53	10.54
Total	**163.09**	**281.61**	**305.27**	**218.86**	**181.97**
Profit/Loss	5.55	(-) 46.80	(-) 80.44	(-) 12.41	(-)10.74
Percentage of financial charges to total income (excluding sales & grants/subsidies)	47	53	55	58	52
Percentage of employees cost to total income (excluding sales and grants/subsidies)	19	23	43	53	45

Annexure-10

(Referred to in para 13.6)

Norms for financial assistance for general category* and procedure for sanction

Name of scheme	Maximum amount of assistance	Period of repayment	Period of moratorium allowed	Security **	Procedure for sanction/disbursement
Hire Purchase/ Equipment Leasing	Rs.25 lakh to Rs.1.00 crore	5 years in 20 quarterly instalments (except special equipment)	6 to 12 months	20/25 per cent of loan amount to be obtained as cash towards security deposit.	After examining the economic viability of the project, security offered, creditworthiness of the promoter, working capital arrangements and ensuring clear title of the primary security mortgaged.
Raw Material Assistance/ Bill Discounting	Rs.1 crore	90 days	--	100 per cent bank guarantee	Direct payment to the supplier against the evidence of supply received under RMA. Bills drawn by the assisted units for the supplies made to the reputed enterprises and accepted by them, are financed under Bill Discounting.

*In respect of other categories such as SC/ST, Women entrepreneurs and North-Eastern Region, the quantum of assistance differs and concession in rates of interest is offered.

** Security norms have been revised from February 2004.

Annexure-11
(Referred to in Para 13.7)
Trend in recovery of dues

(Rs. in crore)

	Amount due at the beginning of the year	Fallen due during the year	Total recoverable	Recovered during the year	Dues written off during the year	Amount due at the end of the year	4 as percentage of 3
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
1998-99							
HP	78.28	8.60	86.88	13.25	2.51	71.12	15.3
EL	11.70	10.40	22.10	8.94	0.17	12.99	40.5
RMA	123.05	203.68	326.73	181.10	--	145.63	55.4
BD	32.00	73.33	105.33	47.90	--	57.43	45.5
Total	**245.03**	**296.01**	**541.04**	**251.19**	**2.68**	**287.17**	**46.4**
1999-2000							
HP	71.12	9.12	80.24	9.53	*1.76*	*68.95*	11.9
EL	12.99	9.18	22.17	7.93	0.05	14.19	35.8
RMA	145.63	255.71	401.34	241.20	--	160.14	60.1
BD	57.43	64.85	122.28	71.60	--	50.68	58.6
Total	**287.17**	**338.86**	**626.03**	**330.26**	**1.81**	**293.96**	**52.8**
2000-01							
HP	68.95	10.55	79.50	9.90	1.87	67.73	12.5
EL	14.19	9.97	24.16	10.62	0.05	13.49	44.0
RMA	160.14	262.68	422.82	282.91	0.01	139.90	66.9
BD	50.68	77.46	128.14	80.77	0.01	47.36	63.0
Total	**293.96**	**360.66**	**654.62**	**384.20**	**1.94**	**268.48**	**58.7**
2001-02							
HP	67.73	12.09	79.82	9.83	1.37	68.62	12.3
EL	13.49	5.50	18.99	5.03	0.20	13.76	26.5
RMA	139.90	220.26	360.16	238.06	0.04	122.06	66.1
BD	47.36	79.28	126.64	82.95	--	43.69	65.5
Total	**268.48**	**317.13**	**585.61**	**335.87**	**1.61**	**248.13**	**57.4**
2002-03							
HP	68.62	14.04	82.66	12.48	0.31	69.87	15.1
EL	13.76	3.65	17.41	4.17	0.10	13.14	24.0
RMA	122.06	153.62	275.68	177.36	--	98.32	64.3
BD	43.69	54.49	98.18	66.49	--	31.69	67.7
Total	**248.13**	**225.80**	**473.93**	**260.50**	**0.41**	**213.02**	**55.0**

HP – Hire Purchase
EL – Equipment Leasing
RMA – Raw Material Assistance
BD – Bill Discounting