Chapter II

Performance review relating to Government Company

2 Working of Kerala Electrical and Allied Engineering Company Limited

Executive Summary

Kerala Electrical and Allied Engineering Company Limited is a PSU under the administrative control of Industries Department, Government of Kerala with a business objective of maximising profit growth by carrying on the business of Electrical, Mechanical and Structural Engineering and Manufacturing Engineering equipments, fittings and electrical accessories.

The Company with different ranges of products has five manufacturing units and 867 employees catering to the vital sectors of Railways, Electricity Boards and Electrical consumers.

Financial position and working results

The finalisation of accounts from 2007-08 onwards has been delayed. The accumulated loss which stood at ₹ 90.78 crore in 2005-06 decreased marginally to ₹ 86.02 crore in 2009-10. As per the provisional accounts, Mamala, Kundara and Kasaragod units had shown profits during 2007- 08 and 2008-09.

Production performance

The company suffered from poor capacity utilisation. It did not have adequate work orders. There was no substantial upgradation of plant and machinery during the last five years. Shortcomings in plant facilities like non synchronisation of activities of the operating units contributed to poor production performance.

Purchase policy

The Company had not evolved a centralised purchase policy though the value of consumption of raw material and components was around ₹ 60 crore annually.

Consumption of raw materials

Excess consumption of major raw materials compared to the norms fixed was noticed in different units.

Absence of costing system

There was no scientific costing system to compute the cost of production, resulting in Company accepting orders below cost at Kundara, Kasaragod and Mamala units to keep them working.

Absence of credit policy

The Company had not formulated a centralised credit policy specifying maximum credit limits. As a result, there was huge accumulation of sundry debtors.

Manpower management

Management failed to determine the staff requirement at various units in a scientific manner based on the turnover and the work requirement. Instances of low employee productivity were also noticed.

Introduction

2.1 The Kerala Electrical and Allied Engineering Company Limited (Company) was incorporated in June 1964. Its core areas of business are electrical, mechanical and structural engineering and manufacturing engineering equipments, fittings and electrical accessories. The Company has five manufacturing units situated in different parts of the state viz., Mamala (Distribution transformers and Civil / Structural works), Kundara (Train lighting Alternators), Kasaragod (General Purpose Alternators), Olavakkod (Fuse Units and Switch gears) and Edarikkod (Brushless Auto Alternators) catering to the vital sectors of Railways, Electricity Boards and Electrical consumers. The Company is under the administrative control of Industries Department, Government of Kerala.

The overall administration of the Company is vested with the Board of Directors, consisting of 13 Directors including Managing Director and Chairman appointed by the Government of Kerala. The Managing Director is the Chief Executive of the Company assisted by officers and staff. The Company also has Regional Offices in Delhi, Mumbai, Kolkatta, Chennai, Bangalore and Thiruvananthapuram for marketing and servicing activities.

Scope of Audit

2.2 The Company is a major industrial concern of the Government of Kerala. The Company has been running in loss since 1987-88 except for two years in 1989-90 and 1996-97. The Company has earned profit during 2007-08, 2008-09 and 2009-10 as per provisional accounts. The accumulated loss as at the end of 31/03/2010 was ` 86.02 crore. The performance review conducted during February 2010 to May 2010 covers the operational activities of the Company at its manufacturing units at Mamala, Kundara, Kasaragod, Olavakkod and Edarikkod for the five years 2005-2010. In order to ascertain the causes for consistent loss and suggest scope for improvement of operations the Company was selected for Performance Review.

Before taking up the review an entry meeting was conducted (February 2010) to discuss the scope of Audit, Audit objectives / criteria / methodology and major areas for Audit. The meeting was attended by the Secretary to Government of Kerala, Industries Department and the Managing Director of the Company.

The working of the Company was last reviewed and included in the Report of the Comptroller and Auditor General of India (Commercial), Government of Kerala for the year ended 31 March 1996. The Report was discussed by the Committee on Public Undertakings (COPU) and their recommendations were included in its 53rd Report (2001-04) which was presented to the Legislature on 20 January 2004. The action taken on the recommendations was placed in the Legislature on 22 March 2005.

Major recommendations of COPU and the action taken thereon / progress thereof are mentioned below.

Para No.	COPU Recommendation	Action taken / Progress
29	Company should conduct a proper market survey and put in all out effort to sell their product in the domestic market. Prospects of exporting its products may also be explored.	• The Company has conducted a study through M/s Deloitte to assess the marketability and scope for diversification during 2008-09. Action on their report is awaited. • The Company achieved export orders valuing ₹ 5.42 crore during the last five years.
30	While preparing the budgeted sales, the capacity of machinery, average sales during the past five years, the expected sales during the year etc., should be taken into account.	• The Company has prepared the budget (production / sales) based on the expected sales (requirement and demand pattern of the Indian Railways and KSEB).
31	The number of employees was disproportionately high compared to the actual output in Kasaragod unit and suggested austerity measures for recruitment to the need.	• Against the strength of 1010 employees in 2005-06 the present strength was 947 in 2009-10, in the Company as a whole. • The Company has recruited 60 need based employees during the review period. • In respect of Kasaragod unit the strength in 2005-06 was 238 which reduced to 220 in 2009-10. • The Company has not assessed the manpower requirement and no sanctioned strength is fixed. • The Company appointed (June 2010) Kerala State Productivity Council for conducting organisation study at Mamala and Kundara units. Their study is in progress.
34	The viability of the Edarikkode project on brushless auto alternator should be assessed and if it is found financially and industrially viable, steps should be taken to revive the project and make it functional immediately.	The Company constituted (March 2005) a Committee for revival of project. As the marketability of the product was doubtful the Company decided to use the facility for other activities to supplement the production of Mamala unit. The Commercial production, however, from this unit is yet to commence.

Audit Objectives

2.3 We have selected the Company for performance review as it failed to mobilise sufficient working capital and suffered loss due to lack of professionalism in managing various resources to improve the productivity. The audit objectives of the performance review were to ascertain whether;

- the available resources were utilised economically, efficiently and effectively;
- the procurement and contract management system was efficient and performance oriented;
- financial resources were correctly estimated, mobilised and utilised;
- the efficiency of the marketing system was ensured for timely supply of quality product at competitive price and timely realisation of dues;
- there was effective manpower management; and
- the Management Information System / Internal Control / Internal Audit system / Corporate Governance practices were effective.

Audit Criteria

2.4 The topic was selected for Performance Audit Review to assess the performance and suggest improvements. To achieve this end the following audit criteria were adopted:

- targets fixed by the Company in production / material / sales budgets;
- norms in respect of consumption of material and power;
- procurement, sales and credit policy;
- systems and procedures for correct estimation, mobilisation and utilisation of funds;
- human resource policies of the Company; and
- policies and guidelines prescribed for Management Information System / Internal Control / Internal Audit / Corporate Governance.

Audit Methodology

2.5 Audit adopted the following methodologies:

- review of Board minutes, agenda notes and minutes of other committee meetings;

- scrutiny of production / material / sales budgets;
- analysis of production reports / statements;
- scrutiny of purchases / work contracts / transportation arrangements;
- scrutiny of sales orders and sales realisation particulars;
- examination of records in respect of estimation, mobilisation and utilisation of funds;
- review of MIS reports/Internal Audit Reports / Study Reports / Project Reports / Annual Accounts; and
- interaction with the officials of various divisions / departments.

Financial Position and Working Results

2.6 Financial position and working results of the Company during the five years 2005- 2010 are given below:

Financial Position **(` in crore)**

Particulars	2005-06	2006-07	2007-08	2008-09	2009-10
Liabilities				(Provisional)	
Share capital and Advance	71.38	71.38	87.15	87.15	87.15
Reserves and Surplus	0.16	3.66	3.66	3.66	3.66
Borrowings	45.36	47.53	29.45	29.82	28.01
Total	**116.90**	**122.57**	**120.26**	**120.63**	**118.82**
Assets					
Net fixed assets	4.07	2.98	2.42	2.21	2.57
Project work in progress	5.39	5.60	5.89	6.14	6.14
Net current assets	14.00	17.77	21.13	24.86	24.09
Miscellaneous expenses not adjusted	2.66	1.77	0.88	--	--
Accumulated loss	90.78	94.45	89.94	87.42	86.02
Total	**116.90**	**122.57**	**120.26**	**120.63**	**118.82**
Net worth[1]	**(-) 19.24**	**(-) 19.41**	**0.87**	**3.39**	**4.79**

[1] **Paid up capital plus reserves and surplus less accumulated loss.**

Working Results

Particulars	2005-06	2006-07	2007-08	2008-09	2009-10
Income				(Provisional)	
Gross Sales / Works contract, other income	59.44	83.49	101.03	106.10	105.65
Increase / (Decrease) in stock	6.80	(8.39)	2.65	0.62	(1.90)
Total	**66.24**	**75.10**	**103.68**	**106.72**	**103.75**
Expenditure					
Materials consumed	34.03	37.84	58.47	60.74	61.40
Employee costs	17.88	15.85	13.19	16.70	18.90
Others	29.03	25.07	27.52	26.76	22.05
Total	**80.94**	**78.76**	**99.18**	**104.20**	**102.35**
Profit / (Loss)	**(14.70)**	**(3.66)**	**4.50**	**2.52**	**1.40**

Accounts from 2007-08 onwards have not been finalised.

The accounts of the Company are in arrears from 2007-08 onwards. Acute shortage of manpower in accounts department was attributed as one of the reasons for delay in finalisation of accounts. We observed that to make the accounts up-to-date a Chartered Accountant was also engaged on contract basis.

It could be seen from the table that:

The accumulated loss of ` 90.78 crore in 2005-06 decreased to ` 86.02 crore in 2009-10.

- the accumulated loss, which was ` 90.78 crore in 2005-06 marginally decreased to ` 86.02 crore in 2009-10, mainly due to increase in sales and profit in operation in Mamala and Kasaragod units.

- the income from operating activities gradually increased from ` 59.44 crore in 2005-06 to ` 105.65 crore in 2009-10. Correspondingly, the value of raw materials consumed also increased from ` 34.03 crore in 2005-06 to ` 61.40 crore in 2009-10.

Audit findings

2.7 Audit findings emerging from the performance review were reported to the Management / Government of Kerala in July 2010 and were discussed in an exit meeting (August 2010), with the Secretary (I P), Industries Department to Government of Kerala, the Chairman and the Managing Director of the Company. The views expressed in the meeting have been taken into consideration while finalising the performance review.

Investment in Edarikkod unit

2.8 The Edarikkod unit of the Company was established (1995) to manufacture Brushless Auto Alternators (BAA) with a total investment of ` 3.18 crore. The investment (including pay and allowances of workers in the project - ` 4.48 crore upto March 2003) without assessing the marketability of the product and ensuring availability of funds was commented in the Report of the Comptroller and Auditor General of India (Commercial) for the year ended 31 March 2003. The COPU which discussed the lack of progress of the project based on the Report recommended (March 2005) to assess the financial and industrial viability of the project and if it was viable, steps should be taken to revive the project and make it functional immediately.

The Company, thereafter, constituted (March 2005) a Committee for revival of the unit and procured (June 2005) machinery and attempted production activities. The attempt also did not meet with success due to lack of sufficient orders and skilled manpower. Even though there were insufficient jobs for existing manpower, the Company kept on posting more staff / workers from other units in excess of requirement. We observed that the Company invested ` 37.14 lakh in machinery and incurred expenditure of ` 1.39 crore (Salary ` 1.25 crore and Power charges ` 14.79 lakh) during 2004-2010.

Management stated (August 2010) that the production of distribution transformers from Edarikkod unit started from December 2009 at the rate of 100 numbers per month. The GoK sanctioned (March 2010) ` 3.00 crore for revival of the unit and had released ` 1.46 crore. We observed that the transformers were produced on contract basis to supplement the orders of Mamala unit due to favourable order position in that unit during 2009-10 which can not be expected to be a permanent feature.

Production

Production planning

2.9 Production planning is a process used by manufacturing companies to optimise the efficiency of their process. Each unit prepared annual production plan based on the delivery schedule of pending and anticipated orders but:-

- Plant capacity was restricted by the low productivity of machineries and equipments and bottleneck in operations;
- All machines did not operate at evenly balanced speed and efficiency, resulting in imbalance between the work loads of different machines. The flexibility of the plant dependent upon its ability to adapt to the introduction of new products, changes in the product mix to increase the production were not present. The Management stated (August 2010) that upgradation of existing machinery could not be done due to shortage of funds. We observed that shortage of funds were due to poor recovery of dues from customers and inability to raise loans from commercial banks.

2.10 Unit-wise production performance against the budgeted and installed capacity during the five years 2005-10 are given in ***Annexure 7***.

It could be seen from the Annexure that:

- The Company itself had set the budgeted production to the installed capacity ranging between 41 and 54 *per cent* in Kundara (Alternators), 59 and 84 *per cent* in Mamala (Transformers) and 25 and 31 *per cent* in Kasaragod (General Purpose Alternators). The Company knew of low demand for its products and low market share which made it keep its budgeted production low.

- The actual production was also at variance with the budgeted production. It was ranging between 68 and 117 *per cent* in Kundara (Alternators), 78 and 179 *per cent* in Mamala (Transformers), 30 and 102 *per cent* in Olavakkod (Switch Gears) and 75 and 116 *per cent* in Kasaragod (General Purpose Alternators).

- The actual production to installed capacity ranged between a poor 6 and 21 *per cent* in Olavakkod (Switch Gears), 48 and 146 *per cent* in Mamala (Transformers), 37 and 59 *per cent* in Kundara (Alternator) and 21 and 29 *per cent* in Kasaragod (General Purpose Alternators).

The Kundara unit was having a Foundry Division with an induction type foundry (installed capacity 1500 Metric tonne per annum) since 1985. The foundry was producing castings for axle / alternator pulleys for train lighting alternators for captive consumption and requirements of Kasaragod unit as also sale of raw casting to few private parties. The details of capacity utilisation, cost of production per Kilo gram (Kg) and the selling price per Kg of the foundry during the five years 2005-10 are given in ***Annexure 8***.

We observed that the average capacity utilisation was a dismal 28 *per cent* of the installed capacity during the five years 2005-10. The foundry was working for only single shift per day. The cost of production varied from ` 39.65 to ` 54.88 per Kg while the selling price varied from ` 37 to ` 55 per Kg during 2005-10. The castings produced by the unit were costlier than the prevailing market rate and did not find market. The increased cost of inputs also affected the profitability.

We observed that the Management did not take initiative either to increase the production and diversifying casting range or to ascertain whether it would be profitable for the Company to make itself or buy the castings. Since the casting is the input for manufacture of train lighting alternator, procuring castings from the market at cheaper price would have resulted in cost reduction, competitive pricing and increased profitability.

Management stated (August 2010) that procuring casting from the market at cheaper rates would adversely affect quality of their products. We noticed that Kasaragod unit has been procuring machined castings from private parties and no instances of quality complaints were reported so far (October 2010).

Shortfall in production targets and commercial losses

2.11 Production though below capacity, the Company still did not adhere to delivery schedules fixed by the customers. The Company faced penalty /

liquidated damages by the customers (referred to in paragraph ***2.25***). The Company also lost price variation benefits due to delay in supply (referred to in paragraph ***2.23***) indicating improper management of resources to ensure uninterrupted production.

Plant and machine efficiency

2.12 Investment in plant and machinery and expenditure on repairs and maintenance during the five years 2005-2010 are given below.

(` in lakh)

Particulars[2]	Kundara	Mamala	Kasaragod	Olavakkod
Written down value of plant and machinery (31 March 2005)[3]	9.83	31.83	213.73	2.24
Additions	15.36	23.60	23.28	--
Expenditure on repairs and maintenance	5.52	1.44	18.67	--

No substantial upgradation of plant and machinery during the last five years and the plant lay out was improper.

There was no substantial upgradation of plant and machinery in Kundara, Mamala and Olavakkod units during the review period. Kundara unit with its foundry of 1947 make machinery was taken over at the instance of Government of Kerala (GoK) in 1963 and was diversified (1974) into the production of Brushless Alternators for Indian Railways and was upgraded to a mechanised one in 1985. The plant lay out is not sequential to facilitate movement of raw materials to stage of completion without interference of back tracking to minimise the movements of material handling. A proposal submitted (2008) by the Company for standardisation and modernisation of the Kundara plant involving investment of ` 14.88 crore was yet (October 2010) to get approval of GoK. Mamala and Olavakkod also had similar problems. As the Company had not modernised the machinery and re-engineered the processes in the units, even the minimum production efficiency could not be achieved in operations.

Materials management

2.13 To ensure uninterrupted production, various materials used as inputs, such as raw materials, consumables and spares are required to be purchased and made available to the production shop as and when needed. Therefore, efficient management of input materials is of paramount importance for maximising productivity.

The Company had not framed any definite policy for procurement of raw materials and components required in bulk for use with a view to reduce procurement cost. Each unit used to make assessment of the requirements of major raw materials based on production requirement for next two to three months. Enquiries were issued to suppliers as per the list maintained by the purchase department. Limited offers only were received in the case of high

[2] In respect of Edarikkod unit the expenditure incurred on plant and machinery is shown as project expenses.
[3] Total original cost of plant and machinery held by the Company as on 31 March 2005 was ` 16.84 crore.

value items like lamination, torroidal core etc., as the source of supply was limited. Purchase Committee (PC) was constituted[4] at unit level for making purchase of raw materials valuing upto ` 2 lakh and approval of Corporate Office was sought for purchases exceeding ` 2 lakh.

Consumption of raw materials was ` 42.98 crore and ` 81.20 crore at Kundara and Kasaragod units during the review period and it was ` 108.05 crore during the last four years ending 2009-10 at Mamala unit.

Systemic lapses in purchase

2.14 The systemic deficiencies such as lack of purchase policy, lapses in placement of purchase orders etc., highlighted at Paragraph No. 2B.6.1 in the Report of the Comptroller and Auditor General of India (Commercial) for the year ended 31 March 1996 are yet to be addressed. Although the value of consumption of raw materials and components had increased from ` 34.03 crore in 2005-06 to ` 61.40 crore in 2009-10 formal contracts were not entered into with the suppliers to ensure legal validity. The purchase orders did not contain any standard terms and conditions to safeguard the interest of the Company.

We also noticed that the Company paid liquidated damages to its customers for belated supply for want of materials, which could not be passed on to its suppliers due to absence of proper procurement policy. The deficiencies in the procurement system resulted in the Company incurring extra expenditure in the following instances:-

- Supply of 200 Kilo Litre (KL) of Transformer Oil (TO) to meet the production schedule during January to March 2008 at Mamala unit was not done at agreed rate. The party supplied only 20 KL at the agreed rate and the balance 180 KL was supplied upto July 2008 at higher rate resulting in extra expenditure of ` 22.36 lakh.

- In Kundara (Alternator division) considerable delay ranging even upto eight months in getting 'torroidal core' after placement of orders were observed. Similarly there was delay ranging upto six months in getting 'laminations' from regular suppliers. The delay in supply / short supply resulted in interruption of production and loss of 6508 mandays due to idling.

We observed that the unit did not pursue with the suppliers vigorously to minimise delay. The Management replied (August 2010) that working capital shortage was one of the major constraints for timely placement of orders. We observed that the Company had sufficient working capital to manage its raw material requirement but the system of prioritisation of payments to suppliers was not effective due to delay in receipt of payments from its customers.

[4] **Purchase Committee: DGM (Marketing), DGM (Materials), DGM (Design), DGM (Production), AM (Finance) and unit head.**

2.15 Inventory control techniques mainly consist of classification of inventory, fixation of minimum, maximum; re-order levels and economic ordering quantity of each item of inventory, identification of slow/ non-moving / obsolete item of inventory, minimising inventory carrying cost and disposal of obsolete / undesired items of inventory etc.

A system of annual physical verification of stock of finished goods and raw materials was in place in all the four units of the Company. Obsolete / slow moving materials valuing ` 23.40 lakh were accumulated in two units (Kundara and Kasaragod) for more than five to ten years despite having a system for identifying the same. The Company replied (August 2010) that action to dispose of the materials is being taken.

The Company had been catering to the requirement of various products from institutional as well as individual customers according to their specifications. However, non / delay in lifting of finished goods by the customers within the agreed period in Kundara, Mamala and Olavakkod units led to accumulation (ten to 108 months) of finished goods resulting in blocking of funds amounting to ` 86.97 lakh with interest[5] burden of Rs ` 40.81 lakh ***(Annexure 9)***.

Excess consumption of raw materials

Consumption of the major raw materials was in excess of norm valuing ` 1.29 crore.

2.16 The norms for consumption of raw material are fixed at unit level. A comparison of actual consumption of major raw materials with the norms fixed revealed that there was excess consumption in respect of four major raw materials in Kundara and Kasaragod units valuing ` 1.29 crore during the five years 2005-2010.

Company replied (August 2010) that the raw material might have been consumed for repair and supply of spares used for failed product in Kundara unit. These items could not be segregated and properly accounted for. Out of the total excess consumption of ` 1.29 crore 60 *per cent* pertained to Kasaragod unit. The Management assured (August 2010) that the reasons for excess consumption would be analysed.

Marketing

Sales performance

2.17 The budgeted sales, actual sales, sales to major customers, profit/loss in four manufacturing units during 2005-10 were as follows:

(` in crore)

Year	Particulars	Units			
		Kundara	Mamala	Kasaragod	Olavakkod
2005-06	Budgeted Sales	15.47	29.61	19.10	2.50
	Actual Sales	14.06	22.38	20.36	0.74
	Percentage of actual sales	90.88	75.58	106.60	29.60

[5] **Interest calculated at the borrowing rate of 14.50 *per cent.***

	to Budgeted Sales				
	Sales to major customers	11.91	10.34	14.65	--
	Percentage of sales to major customers to total sales	85	46	72	--
	Profit / (loss)	(0.40)	0.35	(0.73)	(0.35)
2006-07	Budgeted Sales	15.46	29.37	22.55	2.50
	Actual Sales	15.52	25.00	39.45	0.62
	Percentage of actual sales to Budgeted Sales	100.38	85.12	174.94	24.80
	Sales to major customers	14.79	9.82	34.56	--
	Percentage of sales to major customers to total sales	95	39	88	--
	Profit / (loss)	(3.65)	(4.20)	4.78	(0.59)
2007-08	Budgeted Sales	20.82	36.58	26.65	3.23
	Actual Sales	18.49	34.58	39.49	2.72
	Percentage of actual sales to Budgeted Sales	88.81	94.53	148.18	84.21
	Sales to major customers	15.07	20.73	35.46	--
	Percentage of sales to major customers to total sales	82	60	90	--
	Profit / (loss)	0.33	1.10	3.20	(0.13)
2008-09	Budgeted Sales	22.77	42.35	34.00	3.00
	Actual Sales	20.24	45.20	33.14	2.43
	Percentage of actual sales to Budgeted Sales	88.89	106.73	97.47	81.00
	Sales to major customers	17.11	19.27	28.70	--
	Percentage of sales to major customers to total sales	85	43	87	--
	Profit / (loss)	0.04	2.19	0.65	(0.36)
2009-10	Budgeted Sales	21.94	47.77	40.76	4.00
	Actual Sales	16.34	63.36	16.71	2.11
	Percentage of actual sales to Budgeted Sales	74.48	132.64	41.00	52.75
	Sales to major customers	11.52	41.30	7.54	--
	Percentage of sales to major customers to total sales	71	65	45	--
	Profit / (loss)	(2.97)	7.27	(2.91)	0.01

It could be seen from the above that provisional accounts of Mamala, Kundara and Kasaragod units had shown operational profits during 2007-08 and 2008-09. The achievement of sales in Kundara ranged between 74.48 and 100.38 *per cent* of targeted sales during the period 2005-2010. Mamala unit achieved more than the targeted sales during 2008-09 (106.73 *per cent*) and 2009-10 (132.64 *per cent*) and consistently managed higher sales except during 2005-06 (75.58 *per cent*) due to reduction in orders from KSEB. Olavakkod unit achieved sales of 29.60 *per cent* and 24.80 *per cent* to the budgeted sales during 2005-06 and 2006-07 respectively. Better demand from KSEB and private customers during 2007-2009 increased the actual sales up to 84.21 *per cent* and 81 *per cent* of budgeted sales respectively but it came down to 52.75 *per cent* in 2009-10. Kasaragod unit achieved 174.94 *per cent* and 148.18 *per cent* against the targeted sales during 2006-07 and 2007-08 respectively due to the increase in orders from Railways. In 2008-09 and 2009-10, however, the actual sales decreased to 97.47 *per cent* and 41.00 *per cent* respectively due to reduction in orders from Railways.

We observed that the marketing departments of units did not evolve new strategies to increase the customer base with attractive yet remunerative pricing and credit policy. We recommend that the Company should follow market savvy techniques to stay in competition.

Poor success rate in tenders

2.18 The Company had not formulated any policy / guidelines for participating in tenders invited by State Electricity Boards / Utilities, Railways and other customers. Each unit participated independently in tenders floated by the institutional customers like Indian Railways, State Electricity Boards / Utilities etc., for supply of standardised products and quoted on the basis of estimate prepared by their marketing departments. We noticed that the success rate in tenders in respect of Mamala unit (Transformer) was 4 to 16 *per cent*, Kasaragod unit (Alternators) was 6 to 25 *per cent* and that of Kundara unit was 11 to 27 *per cent* during the review period. The data in respect of Olavakkod unit was not available. The Company replied (August 2010) that the poor success rate was due to stiff competition from private sector enterprises. It is observed that the Company is losing on orders because of higher fixed costs.

We recommend that the Company must follow a pragmatic policy and may quote for tender above its marginal cost so as to fetch orders and ensure contribution towards recovery of fixed cost as well.

Non- diversification of customer base

2.19 The three units viz., Mamala, Kundara and Kasaragod were dependent only on single customer for its sales. In respect of Olavakkod unit the orders were evenly received from KSEB and private customers.

- Mamala unit derived above 57 *per cent* of its sales from KSEB during the years 2007-08 and 2009-10. The second major customer of the unit was Tamil Nadu Electricity Board (TNEB) with average share of around 20 *per cent* of the total sales except in 2007-2008.

- Kundara unit derived 83 *per cent* of its sales from Indian Railways during 2005-2010. The revenue from sale of castings to Kasaragod unit was on an average three *per cent* of the total sales. The revenue from other sources constituted an average 14 *per cent* of the total sales.

- Kasaragod unit derived 86 *per cent* of its sales from Railways except in 2009-10 when the sales declined to 45 *per cent* of the total turnover due to reduction in orders.

The dependence on single customer for the bulk of the sales revenue poses a high risk to the sustainability of the units in the present environment. For example, the sales of Kasaragod unit for the year 2009-10 took a hit due to reduced orders from Indian Railways. We recommend that the Company must expand its customer base to survive in the competitive market.

Expenditure incurred (2005-10) on two regional offices amounting to ` 91.58 lakh became wasteful due to non-canvassing of orders.

The Company had not taken any effective action to increase its market share by resorting to marketing / advertisement campaigns etc., in trade journals or Industry manuals etc., to create awareness and interest in its products. The Company is having Regional Offices at Mumbai, Chennai, Delhi, Kolkatta, Bangalore and Thiruvananthapuram for marketing and liasoning purpose and incurred ` 2.75 crore towards salaries and administration expenses for the review period of 2005-10. Apart from this an amount of ` 1.33 crore was paid as sales commission to marketing agents. It was noticed that Mumbai and Delhi offices had not procured orders during the review period. Orders were procured through the efforts of marketing departments at unit level by participating in tenders and through private marketing agents appointed on commission basis. The expenditure amounting to ` 91.58 lakh on salary and establishment expenses (Delhi ` 57.64 lakh and Mumbai ` 33.94 lakh) for the five years (2005-10) did not prove fruitful. The Management failed to monitor the performance of these offices and the purpose for which these were set up. Management stated (August 2010) that after sales services were being attended to from these offices and staff strength were minimal. We suggest that the Company may fix targets for these offices and a managerial decision may be taken for cost reduction in unproductive areas of marketing.

Diversification activities

2.20 The Company appointed (June 2008) M/s Deloitte Touche Tohmatsu India Pvt Ltd, Chennai to conduct a focused study on the diversification options available for the Company to achieve sustained growth and profitability at a fee of ` 11.75 lakh. The study report submitted (March 2009) by M/s Deloitte suggested five diversification options viz., manufacturing of electric motors, power transformers, 'electrics' for locomotives, wind electric generators and industrial fans / blowers involving capital investment of ` 193.23 crore.

The Company had heavier products of the same rating compared to competitors showing that there is opportunity for value engineering.

The report of M/s Deloitte highlighted the lack of value engineering in products by comparing the gross weight of various ranges of alternators manufactured by the Company to that of its competitors such as Stanford, Elgi and Kirloskar and found that it was in excess by seven *per cent* to 36 *per cent*. The consultant had worked out an increase of 26 *per cent* profit by saving two *per cent* in material cost by value engineering. The annual savings on material cost was estimated at ` 1.17 crore. Management stated (August 2010) that a proposal had been submitted to GoK for financing the diversification and steps have been taken for reduction of raw material cost by negotiating price of supplies.

We observed that though the Company analysed and found the recommendations of consultant financially and technologically feasible (March 2009), it had neither fixed any time frame for implementation of these recommendations nor discussed it with staff.

Pricing policy and costing system

2.21 The Company had not adopted any standard scientific mechanism for evaluation of the terms and conditions of purchase orders of customers while accepting their offer. Each unit finalised the selling price on the basis of rough estimate prepared for the purpose of quotation and subsequent negotiations conducted with the customers but not with reference to actual cost data.

We observed that the Company accepted many works and purchase orders from customers and suffered direct loss due to poor evaluation of terms and conditions and bad costing while bidding:

- The Transformer Division of Mamala unit incurred loss of ` 62.78 lakh ***(Annexure 10)*** in three cases due to increase in cost of raw materials during execution of orders whereas the price variation was limited to ten *per cent*.

- Structural Division, Mamala received (September 2008) an order for 26 rail bogie frame from BEML at ` 1,32,500 per frame with an estimated contribution of ` 3,645 per frame. However, the actual cost of fabrication of a bogie frame came to ` 1,76,855 resulting in loss of ` 11.53 lakh due to underestimation of labour man hour rate and overheads.

Unconditional acceptance of tender conditions

2.22 Structural Division (Mamala) undertook fabrication, supply and erection of various gates on dams / reservoirs. Successful execution of such works within the stipulated period was dependant on completion of civil / electrical works which required involvement of various agencies. Therefore, before undertaking such works, the division had to guard against any possible loss on account of delay in completion due to reasons beyond its control.

Unconditional acceptance of tender conditions without safeguarding the financial interest resulted in avoidable expenditure of ` 41.04 lakh in two work orders.

We observed that in at least two cases the division accepted the tender conditions without safeguarding its financial interest and resulted in revenue loss of ` 41.04 lakh.

- The 'Gate works' of Upper Tunga Project Dam (UTP) for Karnataka Neeravari Nigam Limited (KNNL) - Omission to include enabling provisions for reimbursement of extra expenditure on account of price escalation from the customer resulted in avoidable expenditure of ` 20.44 lakh.

- The works of design, fabrication, supply, erection, testing and commissioning of automatic tilting shutters of Bihar State Hydro Electric Power Corporation (BSHEPC), Patna resulted in revenue loss of ` 20.60 lakh.

Loss of price variation claims

Due to delay in supply eligible price variation of ` 73.41 lakh could not be enforced.

2.23 As per the terms and conditions of supply of distribution transformers (Mamala unit) to KSEB, the Company is eligible for price variation (PV) upto a maximum of 10 *per cent* plus or minus on the basic price of the transformer on account of increase / decrease in price of raw materials during the scheduled period of supply. The Company could not supply the items in time due to non- availability of working capital for procuring raw materials resulting in loss of price variation claims amounting to ` 73.41 lakh in five supplies ***(Annexure 11)***.

Loss of revenue due to refixation of price

Due to delay in supply KSEB invoked the price refixation clause which resulted in loss of ` 55.64 lakh to the Company.

2.24 KSEB placed (November 2006) orders for supply of fuse units at ` 3.06 crore and additional order (July 2008) valuing ` 73.98 lakh (Olavakkod unit). In the event of delay in supply beyond the scheduled delivery period, the price of such materials will be refixed taking into account the market price of such materials on the date of actual supply or at the same price as per the purchase order whichever is lower. On account of the delay in supplying the materials, KSEB invoked the price refixation clause and refixed the price of both the orders and recovered ` 55.64 lakh resulting in revenue loss to the Company. The reason attributed for delay was non-availability of funds for procuring raw materials. We observed that the unit had requested for advance of ` 50 lakh from KSEB in March 2007 after three months from receipt of PO and the same was received (June 2007) after expiry of delivery schedule.

Loss due to production delays

2.25 The Company was continuously facing working capital shortage, still it manufactured the products before getting firm commitment from customers and obtaining approval from regulatory authorities. We noticed that due to this anomaly ` 15.20 lakh was blocked up.

- The Bangalore Electric Supply Company (BESCOM) placed (August 2003) an order for supply of 1,500 nos. and additional order (September 2003) for supply of 500 nos. of 15 KVA distribution transformers at ` 19,910 per transformer (Mamala unit). As per the contract, 200 transformers per month had to be supplied from October 2003 and to complete the supply of 1000 numbers by February 2004 and 500 transformers against extension order by May 2004. The division supplied only 115 transformers till December 2004. Hence BESCOM short closed (March 2005) the purchase orders and encashed (April 2005) the Bank guarantee amounting to ` 50,000. Due to short closure of the order 80 transformers not lifted by BESCOM costing

` 15.20 lakh are remaining in stock for more than five years (March 2005-May 2010) resulting in blocking of funds.

- There was failure in keeping up the delivery schedules of KSEB and Indian Railways resulting in levy of liquidated damages (LD). On retention of LD, the respective units appealed to the concerned parties citing reasons for delay in supply. Upto 2007-08 the Indian Railways had released ` 1.25 crore considering the merit of the case. It was noticed that no refund was received since September 2008 though the unit took up the matter with customer. The table below indicates the amount of LD levied for the supplies made upto 2009-10.

Non – adherence to delivery schedules resulted in payment of liquidated damages amounting to ` 3.21 crore.

Unit	Supplies prior to 31/03/2005	2005-06	2006-07	2007-08	2008-09	2009-10	Total
	(` in lakh)						(` in crore)
Kundara (Railways)	76.93	44.79	32.27	55.65	10.93	3.37	2.24
Kasaragod (Railways)	Nil	5.87	26.43	0.94	4.12	2.50	0.40
Mamala (KSEB)	22.56	6.21	23.91	4.39	0.24	Nil	0.57
Total	**99.49**	**56.87**	**82.61**	**60.98**	**15.29**	**5.87**	**3.21**

The factors affecting the timely execution of supply orders included shortage of raw materials / components. The procurement was done in small quantities due to working capital constraints depriving the Company of benefit of reduced prices due to bulk buying.

We also observed that the Company was forced to accept orders from its consumers in order to keep its labour force engaged and minimise losses despite knowing that the conditions in POs were not favourable to it.

Credit policy

2.26 The Company had not formulated a corporate credit policy. The units accept purchase orders from the customers and sales effected on the terms and conditions as specified therein, individually and are not part of larger policy. We noticed:

- absence of a simple penalty clause for delay in receipt of sale proceeds

- non-enforcement of partial advance payment along with PO clause and balance before taking delivery. In the case of limited orders, no price variation clause was included. Units relaxed the terms to maintain sufficient order level. Absence of these terms and conditions resulted in delay in lifting / non lifting of finished goods as discussed in paragraphs ***2.25*** supra and delay in sales realisation etc. In five cases

Relaxation of terms of payment at the request of customers resulted in interest loss of ` 24.48 lakh.

(Annexure 12) the Company sustained interest loss of ` 24.48 lakh due to delay in realisation of dues / delay in lifting.

- There was accumulation of sundry debtors (March 2010) amounting to ` 49.90 crore. The unit /age-wise position of debtors is given below:

Accumulation of sundry debtors (March 2010) of ` 49.90 crore out of which ` 6.89 crore was pending for more than three years.

(` in crore)

	Kasaragod	Kundara	Mamala	Olavakkod	Total
< 1 year	5.95	6.71	23.12	0.66	36.44
1 to 2 years	0.34	1.23	1.09	0.47	3.13
2 to 3 years	0.44	1.35	1.64	0.01	3.44
> 3 years	1.13	1.64	4.08	0.04	6.89
Total	**7.86**	**10.93**	**29.93**	**1.18**	**49.90**

There was no substantial reduction of old debts in respect of Mamala and Kasaragod units leading to working capital crunch at these units. Out of ` 4.08 crore pending for more than three years in respect of Mamala unit an amount of ` 1.19 crore was pending for recovery from KSEB (retention money, price variation claim etc.) for more than three to ten years. Similarly an amount of ` 63.97 lakh due from private parties is pending for more than one to three years (Kasaragod, Kundara and Mamala) indicating that management failed to take possible action for improving recovery of dues. The Company replied that a provision for doubtful debts amounting to ` 4.18 crore had been created.

We recommend that the Management should take a critical view of its debtors and make greater efforts to realise its dues.

Financial Management

Estimation of funds requirement

2.27 To assess the fund requirements, the Company prepared annual financial budgets based on projections regarding purchases, sales and capital expenditure in respect of all manufacturing units.

2.28 Details of working capital of the Company during 2005-10 were as given below:

(**` in crore**)

Particulars	2005-06	2006-07	2007-08	2008-09	2009-10
Current Assets			(based on provisional figures)		
Inventory	26.66	18.77	23.16	23.72	20.75
Sundry debtors	18.78	27.06	31.63	41.56	49.90
Cash and bank	0.96	1.41	0.69	0.72	0.81
Loans and advances	4.79	4.43	3.21	2.23	2.16
Total (A)	51.19	51.67	58.69	68.23	73.62
Current liabilities					
Sundry creditors	14.75	10.10	14.64	16.52	23.01
Other current liabilities	16.81	17.11	16.57	19.81	19.00

Provisions	5.63	6.71	6.35	7.03	7.44
Total (B)	37.19	33.92	37.56	43.36	49.45
Working capital (A-B)	14.00	17.75	21.13	24.87	24.17

In order to tide over the poor working capital position, the Company had cash credit and bill discounting arrangement with a consortium of banks. Accordingly, the units availed the facility to the maximum limit throughout the period. The present Cash Credit (CC) limit of ` 15.15 crore was obtained during 1996-97 when the turn over was ` 65.88 crore. This limit could not be increased in spite of 60 *per cent* increase in turn over as the Company was unable to finalise its accounts in time. Low CC limits contributed to paucity of working capital leading to delay in procurement of raw materials for production and opportunities foregone. Other reasons for working capital deficit were poor operational performance and poor recovery of dues from customers.

Non-remittal of statutory dues

2.29 As per the provisions of Employees Provident Funds & Miscellaneous Provisions Act, 1952, the employer has to remit the EPF contribution (Employer/Employees' share and administrative expenses) of a particular month by 15th calendar day of the next month.

2.30 Payment of contribution for the period from April 2005 to January-2010, in respect of three units (Mamala, Kundara and Olavakkod) was continuously defaulted. As per provisions of the EPF Act (section 7 Q), simple interest at the rate of 12 *per cent* per annum is chargeable for delay in payment of contribution from the due date to the actual date of payment and damages are also leviable (section 14B) for default in payment of contribution at the rate ranging from 5 *per cent* to 37 *per cent* per annum depending upon the period of default. We calculated the liability of the Company for the period April-2005 to Jan-2010 for the damages and penalty as ` 1.04 crore.

Manpower management

2.31 The existing and effective manpower of the Company for five years 2005-2010 was given below.

(Manpower in nos)
(***Value of production ` in crore***)

Unit	Particulars	2005-06	2006-07	2007-08	2008-09	2009-10
Kundara	Existing Manpower	370	371	356	350	344
	Effective Manpower	346	349	338	332	324
	Value of production	15.44	14.66	21.87	21.70	15.34
Mamala	Existing Manpower	293	311	299	293	282
	Effective Manpower	279	298	289	284	269
	Value of production	30.28	25.43	41.18	48.40	61.40
Kasaragod	Existing Manpower	238	235	230	229	220
	Effective Manpower	202	192	192	197	194
	Value of production	17.33	37.37	37.77	32.83	14.72
Olavakkod	Existing Manpower	32	36	37	36	34

	Effective Manpower	28	30	33	32	30
	Value of production	0.78	0.74	3.29	2.76	1.96
Edarikkod	Existing Manpower	5	5	6	6	6
	Effective Manpower	25	14	12	13	24
	Value of production	Nil	Nil	Nil	Nil	Nil
Regional Offices and Registered Office	Existing Manpower	72	64	64	64	61
	Effective Manpower	39	37	39	38	26
Total	Existing Manpower	1010	1022	992	978	947
	Effective Manpower	919	920	903	896	867

The Company employed 867 employees against the existing strength of 947 as at the end of 31 March 2010. The Company has not done any periodic assessment of the manpower needs and has not fixed any sanctioned strength based on the requirement so far.

It could be seen that the management failed to deploy the manpower at various units in a scientific manner based on the requirements so that overstaffing or understaffing at units could be avoided. Management had not formulated any policy for redeploying employees between units. Employees were transferred from one unit to another on ad hoc basis. Terms and conditions of services / pay and allowances / incentives to staff and workers, production norms etc are defined and determined based on Long Term Agreement (LTA) entered into between management and staff/worker's associations. We observed no uniformity of pay and service conditions between units resulting in disparity among employees affecting redeployment. Management commissioned (June 2010) a study by Kerala State Productivity Council to go into job evaluation, assessment of human resources requirement etc.

Low employee productivity

2.32 One of the major factors that influenced rate of production was work norms fixed in LTA. A comparison of standard mandays required for production with actual mandays utilised including overtime during the five years ending 31/03/2010 are given in ***Annexure 13***. It could be seen from the annexure that average mandays utilised was in excess of standard mandays required for actual production by 107 *per cent* in Kasaragod, 51 *per cent* in Mamala and 31 *per cent* in Kundara during the five years 2005-2010. Despite availability of excess manpower the Company paid overtime wages amounting to ` 5.78 crore (2005-10) which was avoidable. It was further observed that there was no maximum limit fixed for engaging employees on overtime in violation of Section 64 (4) (iv) of Factories Act 1948 which had the impact of low productivity during normal working hours. Instances of abnormal overtime hours worked by employees were noticed**.** On a test check 53 instances were noticed in Mamala and Kundara units, where overtime worked by an employee in a month (March 2010) ranged from 100 hours to an impossible 204 hours and 101 hours to 190 hours respectively. These number of OT hours were against working hours norms settled in Factories Act.

Internal Controls and Management Information System

2.33 Internal controls and management information systems, financial management, purchase, sales management procedures etc., were found inadequate. Also internal audit did not cover major functional and critical areas like production, yield, material consumption and wastage, productivity as compared to norms as per LTA, break down of machineries and overtime payment, identification of obsolete / non-moving stock of raw materials and finished goods etc. The internal audit reports were not put up to the Board in the absence of Audit Committee for taking corrective action.

Conclusions

The products of the Company had a brand value due to its quality. However, the Company suffered losses due to lack of professionalism in managing procurement, production and marketing aspects. Non-existence of costing and scientific pricing policy, failure in negotiating tender conditions and the dependence on single customers adversely affected the fortunes of the Company. The Company failed to mobilise sufficient working capital due to poor recovery rate from the customers and inability to raise credit from bankers due to delay in finalisation of accounts. The production efficiency was adversely affected due to usage of obsolete machinery; improper plant lay out, absence of procurement policy and non-achievement of production as per work norms. The Company failed to economise the procurement of raw materials and to achieve the norms fixed for consumption of the same. The Company was often forced to accept the unfavorable terms of the purchase orders received from its customers despite knowing the same. The Company continued with unviable unit at Edarikkod thereby further increasing the losses. The Company failed to assess the actual manpower required, leading to availability of man power in excess of requirement.

Recommendations

We recommend

- ***The Company should take effective steps to implement standard and marginal costing system and frame suitable pricing policy.***
- ***Company should vigorously negotiate against any unfavorable purchase order conditions imposed by the customers to protect the interest of the Company.***
- ***The Company should strengthen the contract documentation.***
- ***The Company should frame appropriate policies and systems for procurement and material management.***

- ***The Company should take effective steps to widen the customer base for its products by creating awareness of the quality and brand name of its products.***

- ***Effective action for timely recovery of dues pending from customer should be taken to improve the working capital position. The Government also should help the Company in this matter.***

- ***Production planning and methodology must keep pace with the time and the portfolio of products be widened.***

- ***Customer base needs to be widened to reduce dependence on Government Departments who themselves are going through transformation and are no longer obliged to give orders to PSUs and are looking for better products at competitive prices.***