Chapter IV

4. TRANSACTION AUDIT OBSERVATIONS

Important audit findings emerging from test check of transactions made by the State Government Companies / Corporations have been included in this Chapter.

Government Companies

Kerala State Beverages (Manufacturing & Marketing) Corporation Limited

4.1 Avoidable payment of interest

Failure of the Company in remitting the prescribed amount of advance income tax based on income of the previous 11.5 months as recommended by COPU resulted in avoidable payment of interest of ` 2.95 crore.

As per Section 234 B and C of the Income Tax (IT) Act, 1961, a corporate assessee has to pay 90 *per cent* of the tax in advance when the amount of tax payable exceeds five thousand rupees per annum. The advance tax is payable in four quarterly instalments between June and March months of the corresponding financial year. Failure to pay at least *90 per cent* of the tax in advance by March attracts interest at the rate of one *per cent* per month (section 234 B of the Act ibid). Similarly for failure to pay instalments of advance tax by specified dates, interest is chargeable at the rate of one *per cent* per month (section 234 C of the Act ibid).

The Company is established for the monopoly purchase and sale of Indian Made Foreign Liquor and beer in the State of Kerala and is liable to pay advance tax on its assessed income under the provisions (section 208) of the Act ibid.

The assessed income of the Company, the advance tax payable on such income and the advance tax actually paid during the last three assessment years ended 2007-08 were as follows:

Assessment year	Total income	Tax payable on total income	Advance tax payable[1]	Advance tax paid
	(` in core)			
2005-06	23.48	8.60	7.74	2.92
2006-07	51.34	17.28	15.55	5.10
2007-08	64.42	21.68	19.51	16.93

[1] **90 *per cent* of tax payable**.

The Company could not remit the required amount of advance tax in any of the years and percentage of advance tax actually paid by the Company ranged between 32.80 (2006-07) and 86.78 (2007-2008). The Company was also not diligent in remitting the quarterly instalments of advance income tax as per provisions of section 234 (C) of the IT Act. Consequently, the Company was liable to pay interest of ` 3.93[2] crore under section 234 (B) and 234 (C) of the Income Tax Act. Out of the penal interest of ` 3.93 crore, the Company has remitted (April 2006 - December 2007) ` 2.95 crore along with self-assessment tax. The Company has appealed against the assessment of income tax which was pending (September 2010) decision.

We noticed (May 2010) that the Company had been assessing the quantum of advance tax on the basis of budgeted profit rather than working out approximate income based on income of the previous 11.5 months which had already been recommended by the Committee on Public Undertakings (COPU)[3]. This was mainly because the Company did not have an effective system to monitor monthly / quarterly sales so as to meet statutory obligations. Thus the Company could not assess and remit the required amount of advance tax, thereby necessitating payment of penal interest of ` 2.95 crore.

Government replied (June 2010) that the practice of the Company was to estimate its income based on the income estimated for a year at the beginning of the year and pay advance income tax thereon. Based on Audit observation and compliance with the recommendations, the Company is now computing profit every month and paying advance income tax accordingly.

The Company is now paying advance income tax assessing the profit every month, but the fact remained that the Company did not comply with the recommendations (February 2004) of COPU in assessing the income tax and necessitated payment of penal interest during 2005-08.

[2]

Assessment Year	Interest u/s 234 (B)	Interest u/s 234 (C)	Total
	(` in crore)		
2005-06	0.90	0.28	1.18
2006-07	--	1.72	1.72
2007-08	0.39	0.64	1.03
Total			3.93

[3] **Recommendations of COPU on para 4.1.2.2 appeared in Report of C&AG (Commercial), Government of Kerala 2000.**

Roads and Bridges Development Corporation of Kerala Limited

4.2 Blocking of funds and unproductive interest

Deficiencies in planning, execution and management of contract for construction of Railway Over Bridges resulted in blocking of funds of ` 31.42 crore besides payment of unproductive interest of ` 13.31 crore and cost overrun of ` 16.17 crore.

The Company is engaged in the construction of highways, over bridges and roads on behalf of the Government of Kerala (GoK) and other Government agencies. The GoK entrusted (April 2000-February 2003) the Company with construction of 50 Railway Over Bridges (ROBs) in lieu of level crossings. Out of this, 19 ROBs were under Memorandum of Understanding (MOU) with Railways and five ROBs were entrusted by the GoK (non-MOU). In the case of MOU works, the entire work (bridge as well as approach road portion) had to be carried out by the Company whereas for non-MOU works approach road portion only had to be carried out by the Company.

The MOU signed between the GoK and Railways, provided that the cost of ROBs will be shared equally between GoK and Railways. The prior approval of the Railways was to be obtained for commencing the Railway portion work and for designs of the ROB.

The Company took up (May 2001-November 2003), the construction of 24 ROBs (19 MOU, 5 non-MOU) and completed (June 2003-June 2009) 15 ROBs (14 MOU, 1 non-MOU) incurring an expenditure of ` 97.65 crore (March 2010) against the estimated cost of ` 59.76 crore resulting in cost overrun of ` 37.89 crore. One[4] ROB was completed in February 2010 and civil work of remaining eight[5] ROBs was yet to be completed (May 2010).

Deficiencies noticed in planning, execution and contract management of nine projects (including one completed in February 2010) are discussed below:

Planning, Execution and Contract Management

The Company did not have a definite plan of action for making available the land required for ROB, awarding of civil work, shifting of utilities, obtaining requisite approval for design and structure of ROB from Railways and other designated authorities. KITCO[6] was appointed as consultants for carrying out the civil works who were responsible for conducting preliminary investigations, preparation of land acquisition and shifting of utilities plan, preparation of drawings, designs and estimates, tendering, cost evaluation of bids and recommendation, supervision of work and checking of bills for passing. Based on the tender evaluation, the civil works were awarded by the Company with a completion period of 12 months. As the completion period of one ROB was

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[4] **Nandi Bazaar.**
[5] **Palakkad Town, Ponnuruni, Koratty Angadi, Vallikunnu, Athani, Kadukkamkunnu, Bekal and Pullepady.**
[6] **A joint venture company owned by IDBI, Govt. of Kerala and banks.**

very short, it was the duty of the Company / Government to make available requisite land free of encumbrances before the commencement of work.

We observed (June 2010) inordinate delay by Revenue Department in making available the requisite land. Non-availability of land and hasty decision to award works before acquiring required land (including shifting of electric, telephone and water supply utilities) affected the smooth execution of works. As a consequence of this, three[7] works were retendered and eight[8] works remained incomplete (September 2010). Failure to complete land acquisition proceedings within the allotted time, led to conversion of notifications for land acquisition de nova in two[9] cases. In eight[10] out of nine ROBs, the work was awarded before acquiring land and the delay in acquisition ranged between 15 months to eight years. In the case of three[11] ROBs there was delay in shifting utilities by two to seven years **(*Annexure 22*).**

MOU with Railways invariably stated that no construction activity should be commenced before obtaining sanction from Railways. We observed that there was no effective mechanism to follow up the matter with Railways for getting the necessary approvals in time. In respect of two[12] works there was delay in getting approval from Railways ranging from six to eight years. In the case of four[13] non-MOU works even though the over bridge portion was to be carried out by Railways, the contracts were awarded for works including Railway portion also by oversight resulting in subsequent stoppage of works, abandonment, etc., causing compensation claims and loss of profit. This was due to lack of coordination with Railways for expediting execution of their portion also simultaneously. The work-wise delay, causes of delay and status of work are given in ***Annexure 22.***

Financial Management

The Government issued (April 2000) orders entrusting work of ROBs with the Company on cost sharing basis with Railways and adequate budgetary support was not made available. Therefore, the Company was constrained to avail term loan from HUDCO (` 54 crore) at 13.75 *per cent* and through issue of bonds (` 25 crore) at 12.25 *per cent*. The repayment of the loan was proposed to be met out of contribution from Railways and budgetary support. As the reimbursement from Railways did not come in time due to delayed completion of works and there was no other available source of income, the Government allowed the Company to collect user fee for bridges for a period of 15 years from the date of direct toll collection agreement, in the case of eight incomplete projects. This also did not fructify due to delay in completion of ROBs. The Company was not even able to repay the HUDCO loan and bonds causing additional interest burden.

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[7] Nandi Bazar, Koratty Angadi and Pullepady.
[8] Palakkad Town, Ponnurunni, Vallikunnu, Athani, Kadukkamkunnu, Bekal, Koratty Angadi and Pullepady.
[9] Vallikkunnu and Palakkad Town.
[10] Nandi Bazar, Palakkad Town, Ponnurunni, Koratty Angadi, Athani, Kadukkamkunnu, Bekal and Pullepady.
[11] Koratty Angadi, Kadukkamkunnu and Bekal.
[12] Nandi Bazar and Koratty Angadi.
[13] Athani, Kadukkamkunnu, Bekal and Pullepady.

Slow progress in implementation of projects resulted in enormous increase in cost of civil works, borrowing cost and overheads. In two cases[14] the Company had to undertake balance works at 156 *per cent* and 140 *per cent* more than original rate involving additional commitment of ` 4.08 crore.

Thus, deficiencies in planning, execution and contract management, absence of effective follow up with Railways and inadequate budgetary support from Government resulted in (March 2009)[15] cost overrun of ` 16.17 crore (***Annexure 23***). As the entire activities were financed through borrowed funds, the progress of work was very poor which resulted in blocking of funds of ` 31.42 crore and unproductive interest of ` 13.31 crore[16] on the nine[17] projects including one project completed in February 2010 (April 2007-March 2010) (***Annexure 24***). As a consequence of persistent delays in finalisation of accounts of the Company, receipt of funds from Railways (20 *per cent* of 50 *per cent* share) was also delayed. This delay further compounded by delay in completion of works, the working of the Company was severely affected, resulting in accumulated losses of ` 34.30 crore (March 2009).

Management stated (August 2010) that the woks of ROBs were entrusted to the Company on condition that the funds for land acquisition would be provided by the Government. Since funds for land acquisition were not received and a portion of land was already available, the Company had proceeded with tendering of work on the expectation that balance land could also be acquired as works progressed. Further, due to involvement of several Governmental agencies in land acquisition, shifting of utilities and obtaining approval from Railways, the expected co-ordination could not be achieved. Although there were delays in completion of ROBs, tendering of work before completion of land acquisition when rates were lower, has proved beneficial to the Company.

The reply of the management was contrary to facts since delay in land acquisition has subsequently necessitated retendering and enhancement of rates resulting in time overrun and overall cost overrun of ` 16.17 crore. The management should have ensured the availability of land before inviting tenders for the works. The social cost associated with delayed completion of ROBs was beyond quantification.

We suggest that the Government should evolve a mechanism, on the lines of single window clearance system, for fast track acquisition of land and provision of budgetary support for ROB projects.

The matter was reported to Government (June 2010); its reply is awaited (October 2010).

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[14] Koratty Angadi and Athani.
[15] The Company has not worked out the estimated cost of the ongoing works on completion.
[16] Calculated based on the expenditure incurred upto March 2007.
[17] Nandi Bazar, Palakkad Town, Ponnurunni, Koratty Angadi, Vallikunnu, Athani, Kadukkamkunnu, Bekal and Pullepady.

Kerala State Civil Supplies Corporation Limited

4.3 Undue benefit to private mills

Decision of the Company to allot OMSS wheat to bulk roller flour mills in contravention of GOI directives deprived the targeted population availability of wheat at ` 14.95 per kg which resulted in undue benefit of ` 6.02 crore to private mills.

Government of India (GOI) released (October 2009) 40,660 MT of wheat to Kerala under Open Market Sales Scheme (Domestic)[18] for sale during November to December 2009 with a view to containing rise in food prices. The wheat was released to the State Government at the rate of ` 12957.40 per metric ton (MT) and the Government was to ensure that the retail prices did not exceed ` 14957.40 per MT (release price of ` 12957.40 per MT plus a maximum of ` 2000 per MT towards handling and transportation cost). As per the allotment, State Government was to lift the allocated quantity of wheat from the godowns of Food Corporation of India (FCI) and distribute the same through Government or semi-Government organisations. Besides, the State Government was entitled to sell wheat to small processors (with monthly consumption of wheat upto 30 MT) of wheat.

Kerala State Civil Supplies Corporation Limited (Company) was entrusted with the responsibility of procurement of wheat from FCI. Even though, the Company expressed (11 November 2009) reservations about the marketability of wheat, the entire quantity of 40,660 MT was allotted (November 2009) to the Company for distribution. Following a meeting convened (November 2009) by Secretary, Food and Commissioner of Civil Supplies, the Company was directed (November 2009) to sell the wheat to willing merchants after charging 50 paise per kilo gram towards administrative overheads. Accordingly, the Company invited (November 2009) expression of interest from private mills and based on response the entire wheat was allotted to 68 private mills in six districts at the rate of `13592[19] per MT. The quantity of allotment ranged between 10 MT to 5500 MT. All the private mills remitted the full amount for the entire quantity allotted up front and the Company in turn remitted the price of 35,550 MT wheat to the FCI. FCI began issue of wheat under OMSS from 30 November 2009. The private mills lifted (November – December 2009) 23541 MT of wheat when the FCI stopped (9 December 2009) further release of wheat on the ground that the Company had flouted the GOI directive by allotting OMSS wheat to bulk roller flour mills.

We noticed (December 2009) that the release of wheat under OMSS was primarily intended to be distributed among retail consumers. The Company, however, under the guise of allotment of OMSS wheat to 68 retail merchants,

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[18] **Government of India introduced the Open Market Sales Scheme (Domestic) [OMSS(D)] for wheat with effect from October 1993. The main objectives of conducting OMSS by FCI was to contain and control inflationary tendencies in the economy, generate storage space in the surplus States to enable FCI to accommodate freshly procured food grains etc.**

[19] **`12957. 40 / MT plus ` 500 towards handling charge of the Company and VAT there on.**

had allotted the entire quantity to bulk consumers (roller flour mills) at subsidised rate applicable to retail supply. As per GOI directives, allotment of wheat under OMSS (D) to bulk consumers ought to have been priced at ` 16032.10[20] per MT instead of ` 13457.40[21] per MT actually charged.

This act of the Company to allot OMSS wheat in bulk to roller flour mills in contravention of GOI directives deprived of the targeted population availability of wheat at ` 14.95 per kg which resulted in undue benefit of ` 6.02[22] crore on 23380.67 MT of OMSS wheat sold to 42 private mills (excluding mills having milling capacity of 30 MT per day) in deviation from the declared objective of the Company.

Government stated (May 2010) that based on the proceedings of Commissioner of Civil Supplies, the Company allotted wheat to bulk consumers, subject to the condition that the wheat will be utilised in Kerala, resulting in increased availability at economical price and reduced cost of wheat to the consumers. The final retail price was to be fixed at issue price plus ` 1.50 per Kg and actual expenses of value addition. The mills were expected to file weekly returns to Director of Civil Supplies / Company giving quantity consumed / sold, selling rate etc. The returns filed by the millers suggest that the wheat has reached the end consumers of Kerala. It was also reported that the Chairman and Managing Director had been directed to recover the amount from those whom the wheat was allotted violating the Government of India guidelines.

On verification of reply of the Government, we observed that the mills were submitting weekly returns indicating quantity of wheat in stock, sold, balance, average selling price of wheat products, viz. maida, sooji, atta, bran flakes, bran fine, etc. Even though, the Department was collecting the returns from the mills regularly, there was no mechanism to watch, whether the wheat products are sold within Kerala. As per stock statements made available by Director of Civil Supplies, in respect of ESSEM Traders, Perinthalmanna to whom 100 MT of wheat was issued, 57.270 MT was seen to be issued to two mills / traders in Coimbatore (Tamil Nadu). Similarly, in respect of PKR Modern Rice Mill, Thenkurrissi, who lifted 1000 MT of wheat, 516.92 MT was sold to Mills outside the State in December 2009. Similar details in respect of other Mills were not available. Further FCI reported (April 2010) to the Secretary, Food and Civil Supplies that as per the daily market prices reported by the State Government there was not much reduction in whole sale / retail price of wheat in Kerala. Therefore, the reply of the Government will not hold good.

Out of the amount deposited by the Company FCI adjusted (July 2010) ` 7.73 crore towards the difference in price in respect of mills who had not lifted allotted quantity in full and ` 7.80 crore was refunded. The differential amount of OMSS (D) amounting to ` 3.07 crore was due from 31 mills which had already lifted entire quantity allotted.

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[20] **As per OMSS scheme for bulk consumers.**
[21] **Excluding VAT.**
[22] **23380.67 MT X (` 16032.10 / MT - ` 13457. 40 / MT).**

As the differential balance amount due from mills has been adjusted by FCI from the advance, the Company is contractually liable to the mills for reimbursing the amount as per the binding agreement by way of expression of interest. The lifting of wheat quota, therefore, did not serve the intended purpose of containing the retail price of wheat in the State and distributed wheat did not reach the intended consumers/retailers.

We suggest that in future when wheat intended for distribution to retail consumers under the OMSS or other GOI scheme is given to Government/ Semi-Government agencies for ultimate distribution, it should be ensured that it is actually reaching the ultimate consumers. The orders of Governments should be followed in right spirit.

The Kerala Minerals and Metals Limited

4.4 Avoidable Expenditure

Failure of the Company to reduce contract demand for power, following the abandonment of expansion project resulted in avoidable expenditure of ` 1.19 crore.

The Company is engaged in production and sale of titanium dioxide pigment (TDP). With a view to enhancing the annual production capacity of TDP from 22000 MT to 100000 MT, the Company took up (2004-2007) implementation of an expansion scheme involving eight projects (in three phases) at a cost of ` 760 crore. The expansion project increased future power requirement and in order to meet this, the Company enhanced (August 2004) the contract demand for power from 12500 KVA (12.5 MVA) to 16000 KVA (16 MVA). An agreement (August 2004) to draw energy at a voltage of 110 KV was also executed with Kerala State Electricity Board (KSEB). According to agreement, the Company was to pay for energy supplied at the EHT tariff for 110 KV consumers at prevailing schedule of tariff issued (November 2007) by Kerala State Electricity Regulatory Commission, the demand charge payable for supply of power at 110 KV was ` 245 per KVA on the highest of recorded maximum demand or 75 *per cent* of the contract demand.

In the Report of the Comptroller and Auditor General of India (Commercial) for the year ended 31 March 2009 it was reported *(paragraph 4.1)* that the Company had shelved[23] (February 2007, March 2008) the expansion project due to enormous escalation in cost and had incurred a wasteful expenditure of ` 58.57 crore consequent thereto.

Even though the expansion project was abandoned by March 2008, the Company continued to draw power with a contract demand of 16000 KVA (16 MVA) instead of reverting to 12500 KVA (12.5 MVA). The recorded maximum demand of the Company ranged between 8671 KVA to 11273 KVA during July

[23] **Mineral Separation Plant, Synthetic Rutile Plant, Oxygen Plant and Desalination Plant in February 2007 and four other Projects in March 2008.**

2008 – August 2010 and as a result the Company had been paying demand charges for 75 *per cent* of the contract demand. Consequently, the Company had to incur avoidable expenditure of `1.19 crore from July 2008[24] to August 2010 (***Annexure 25***).

We noticed (February 2010) that as per the provisions of the agreement with KSEB, the Company was entitled to decrease the contract demand by giving three month's notice. Despite this, the Company did not reduce the contract demand from 16000 KVA (16 MVA) to 12500 KVA (12.5 MVA), the contract demand prevalent before conceptualisation of the expansion scheme.

This inaction of two years to reduce contract demand for power, following the abandonment of expansion project resulted in avoidable expenditure of ` 1.19 crore.

Management stated (June 2010) that although the Company had requested (April 2010) KSEB for reducing the contract demand to 12.5 MVA, action is yet to be taken by KSEB to reduce the contracted demand. The fact remained that the Company initiated action to reduce the contract demand only at the instance of Audit. No further progress was noticed in getting the contracted demand reduced (September 2010) by the Company.

The matter was reported to Government (May 2010); its reply is awaited (October 2010).

Kerala Transport Development Finance Corporation Limited

4.5 Avoidable expenditure on finance charges

Non-transfer of funds from current account to interest bearing cash credit / overdraft account resulted in loss of an opportunity of saving finance charges amounting to ` 0.68 crore.

The Company was formed with the objective of financing Kerala State Road Transport Corporation and other transport undertakings and operators in Kerala. The Company had been availing credit facility in the form of fund based working capital limit / cash credit (CC) / overdraft (OD) to the extent of ` 45 crore, ` 30 crore and ` 20 crore respectively from SBT[25] (March 2007) State Bank of Hyderabad (July 2006) and DLB[26] (April 2007). The interest rate charged by the banks for the credit availed, ranged between 10.50 *per cent* and 14 *per cent*. The Company during April 2007 to March 2010 paid an aggregate amount of ` 15.64 crore as interest for the CC / OD availed. While availing the facility of CC / OD at the above interest rates, the Company was also operating

[24] Calculated based on the application for reduction in contract demand (April 2010) and 3 months' notice period required as per agreement.
[25] State Bank of Travancore (SBT).
[26] Dhanalakshmi Bank Limited (DLB).

current accounts with different branches of six[27] banks without fetching any interest on the balances held.

As per statements of transactions of the banks, the Company held balances in all the current accounts and the monthly minimum balance held during the period April 2007 to February 2010 ranged between ` 0.73 crore and ` 4.06 crore.

The Company, however, failed to monitor its funds requirement and balances held in current account vis-à-vis CC / OD accounts on a daily basis and reduce finance charges through transfer of funds from non-interest-fetching current account to interest-bearing CC / OD account. Had directions been given by the Company to transfer balance above minimum required balances in these non-interest fetching current accounts to CC / OD accounts of the respective banks, there would have been a minimum saving of finance charges amounting to ` 0.68 crore[28] (April 2007- March 2010).

The inadequate monitoring of the fund requirements and non-transfer of funds from current accounts to interest bearing CC/ OD accounts in six banks resulted in loss of opportunity of saving finance charges amounting to ` 0.68 crore (***Annexure 26***).

Management stated (July 2010) that the standing instructions had been given to all banks to automatically transfer the amount lying in respective current accounts over and above minimum balance fixed daily to cash credit account effective from 21/06/2010. Government endorsed (August 2010) the views of management.

Kerala State Backward Classes Development Corporation Limited

4.6 Avoidable committed liability

Failure of the Company to register as a Service Tax Assessee and consequent non-collection / non-remittance of Service Tax on processing fee collected from loanees resulted in avoidable committed liability for Service Tax and interest amounting to ` 0.39 crore.

The Company was formed (1995) with the main objective to promote comprehensive development of backward classes and minority communities in the State by rendering financial assistance in the form of low cost loans to set up self-employment ventures and to undertake other welfare activities. The Company was registered as a non Banking Financial Company (NBFC) in May 2003 and as per provisions of Section 65(105) (zm) of Finance Act 1994, any service provided or to be provided to any person by a NBFC in relation to banking and other financial service is a 'taxable service'. Section 65(12) (ix) of

[27] **State Bank of Travancore, State Bank of India, Industrial Development Bank of India, Housing Development Finance Corporation, Dhanalakshmi Bank Limited and IndusInd Bank.**

[28] **Interest has been worked out after allowing a minimum balance of ` 15 lakh in the case of SBT, Vazhuthacaud and ` 5 lakh in the case of other banks.**

the Act ibid further provides that banking and other financial service shall include lending. Therefore, taxable portion in a lending transaction would be the documentation charges, processing fees and servicing charges collected from loanees. Failure or delay in remittance of service tax would attract penal interest at the rate of 13 *per cent* per annum. The tax on banking and other financial services was introduced with effect from 16/07/2001.

The Company has been lending money to its beneficiaries after collecting processing fee at the rate of 0.50 *per cent* since October 2000 up to 31 March 2006 and 0.75 *per cent* thereafter on loan disbursed except for micro credit[29]. During 2004-09, the Company has disbursed a total loan of ` 386.08 crore to the beneficiaries and collected processing fee of ` 2.69 crore. The applicable service tax payable on the processing fee thus collected worked out to ` 31.63 lakh.

We noticed (October 2009) that although the Company was liable to pay service tax on processing fees collected from loanees, the Company neither registered itself as a Service Tax Assessee with Central Excise Department nor collected and paid service tax amounting to ` 31.63[30] lakh till August 2010. Thus, failure of the Company to register itself as a Service Tax Assessee and consequent non-collection / non-remittance of Service Tax on processing fee collected from loanees resulted in avoidable committed liability for payment of Service Tax (` 31.63 lakh[31]) and interest (` 7.85 lakh) amounting to ` 39.48 lakh ***(Annexure 27)***.

The Company received (January 2010) a demand notice from Central Excise Department for payment of service tax of ` 30.75 lakh (tentative) on processing fee collected during 2004-05 to 2008-09.

The Government replied (May 2010) that Government of India (GOI) had been approached for exemption of the Company from payment of service tax and the response from GOI is awaited (October 2010).

Malabar Cements Limited

4.7 Avoidable loss

Failure of the Company to accept dry fly ash supplied by a contractor led to stoppage of supply, subsequent encashment of bank guarantee and consequent loss of ` 14.49 crore.

The Company is engaged in the manufacture and sale of ordinary portland / portland pozzolana cement (PC / PPC). Dry fly ash (pozzolanic material) is one of the major raw materials in the manufacture of PPC which can be used (15 to 35 *per cent*) in lieu of costlier clinker. In order to ensure regular supply of dry fly ash, the Company entered into (November 2004) a contract with ARK Wood

[29] Processing fee at the rate of 0.25 *per cent* of loan amount subject to a maximum of ` 10000/- was collected against micro credit.
[30] Worked out for the period April 2004 to March 2009.
[31] Calculated @ 13 *per cent* for the period 2004-05 to 2008-09.

& Metals (P) Ltd. (ARK) Coimbatore for a period of nine years (November 2004 to November 2013). The terms of the contract provided that ARK would supply to the Company an average 600 MTs of dry fly ash daily (15000 MT per month) at ` 130[32] per MT. The base rate of ` 130 per MT was subject to annual increase. In addition maintenance cost, electricity charges, water charges and taxes and duties which at that time were nil were reimbursable by the Company. The fly ash was to be supplied from the silo allotted by Tamil Nadu Electricity Board (TNEB) at their Tuticorin Thermal Power Station (TTPS).

As per the provisions of the contract, ARK was to deposit ` 5 lakh (Demand Draft / Bank Guarantee) as security deposit against non-performance of the contract / premature termination of the contract while the Company reserved the right to premature termination of the contract on payment of compensation of ` 50 lakh to ARK, to be secured by a Bank Guarantee. Accordingly, the Company furnished (December 2004) a bank guarantee for ` 50 lakh and ARK furnished a bank guarantee for ` 5 lakh. The contract, however, did not contain damages clause which could safeguard its financial interest against non-supply of dry fly ash by ARK.

The relationship between the Company and the contractor became strained since August 2006, due to reduction in off take, delay in making payments and withholding of electricity charges (` 11.27 lakh) payable as per the terms of contract. The Company also expressed its reservations to ARK for non-furnishing the split up details of the quantities of dry fly ash lifted by them from TTPS and the electricity required. On the other hand, due to low off take of fly ash by the Company, TNEB reduced (December 2007) the allotment by 50 *per cent*. This caused erratic supply initially and ultimately resulted in non-supply (September 2008) by ARK. However, ARK encashed (September 2008) the bank guarantee of ` 50 lakh furnished by the Company attributing delay in release of payment, lower off take and non-payment of power charges. The Bank debited (December 2008) an amount of ` 52.45 lakh to the account of the Company (` 50 lakh towards bank guarantee plus ` 2.45 lakh towards interest). The Company's complaint (February 2009) before the Banking Ombudsman against the action of the Bank in admitting invocation of bank guarantee by ARK was turned down (March 2009) by the Ombudsman on finding that the action of the Bank was in order. In the absence of supply of dry fly ash by ARK, the Company was forced to source dry fly ash from other suppliers which was inadequate to meet its requirements resulting in a loss of ` 14.13 crore[33] (April 2007- May 2010) due to use of costlier clinker in lieu of fly ash.

We noticed that the Company, failed to accept the quantity offered by the supplier in full since September 2006 and delayed payment to the contractor, which resulted in stoppage of supply by the contractor and subsequent encashment of bank guarantee containing compensation clause favourable to the

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[32] Service charges (` 60 per MT) + Silo operation and maintenance cost (` 25 per MT) and investment cost and other incidentals (` 45 per MT).

[33] Worked out based on the difference between variable cost of clinker and landed cost of dry fly ash. Loss accepted by the company i.e ` 2.61 crore (2007-08), ` 4.57 crore (2008-09), at ` 600 per MT calculated on the total requirement – quantity received from other sources during 2009-10 and 2010-11 (upto May 2010).

contractor, resulting in a loss of ` 36.18 lakh[34]. Consequent to the stoppage of supply of fly ash, the Company had to source the material from other sources, which was inadequate to meet its requirements and resulted in loss of ` 14.13 crore (April 2007-May 2010) due to use of costlier clinker in lieu of dry fly ash. In the absence of provisions in the agreement to recover damages for non-supply of dry fly ash, chances of recovery of loss from the contractor were also remote.

Management replied (March / June 2010) that the Company was immensely benefited by the regular supply of dry fly ash so that the Company had to agree for a disproportionate amount of bank guarantee towards performance of the contract. The reply does not hold good as the bank guarantee included disproportionate compensation clause proved disadvantageous to the Company and the cost of alternate clinker used in absence of supply of fly ash was high leading to huge loss to the Company. Further the Company could not safeguard its financial interest for non-supply of fly ash by ARK.

The matter was reported to Government (May 2010); its reply is awaited (October 2010).

Kerala State Coconut Development Corporation Limited

Inadequate arrangement for safeguarding movable and immovable assets

4.8 The Company, incorporated in October 1975 with the main objective of development of coconut industry by providing technical facilities, became non-functional since 1998 on account of continuous / huge losses. The Company has finalised its accounts up to 1995-96 and as per the latest accounts the Company had total assets of ` 2.97 crore (immovable assets: `1.03 crore; movable assets: ` 0.15 crore and current assets, loans and advances: ` 1.79 crore).

Even though the Company is non-functional it still has to ensure that accounts are maintained and the permanent assets are safeguarded through periodic physical verification, arrangements for watch and ward of the assets, and adequate insurance cover. The deficiencies noticed in this regard are summarised as under:

Inadequate maintenance of asset records

The Company needs to maintain 'assets records` for each of the assets with details of the assets showing their location, original cost, accumulated depreciation, technical and engineering specifications of machinery, identification number, etc. We noticed that the Company did not maintain adequate and up-to-date records depicting these vital information. The original Asset Register was also not available with the Company. As a result, even

[34] ` 52.45 lakh as reduced by ` 11.27 lakh payable to ARK towards electricity charges and ` 5 lakh held on bank guarantee.

though the equipments and spares available in the units were physically verified during September 2009, the loss of assets, if any, could not be assessed.

Even though land admeasuring 20.86[35] acres was in possession of the Company as at the end of March 2010, the Company held valid title deed only in respect of 3.59 acres of land (Edappally) and for the rest of the area the Company had only land tax receipts.

Physical verification of assets

As per the policy laid down by the Company, all movable and immovable assets were to be physically verified at least once in a year, by an officer authorised by the Managing Director and the report of discrepancies in the value of assets submitted to the top management for further appropriate action.

We noticed (June 2010) that the Company had conducted physical verification of the assets only once during the period from 2001 to September 2009. Thus, in the absence of earlier records discrepancies and encroachment if any, on the land/building could not be ascertained by the Company.

Disuse of assets

The Company needs to make adequate arrangements for proper maintenance and upkeep of the assets not in use. The Company did not conduct a need based review of the assets so as to decide possible utility of these assets in future or for their timely disposal resulting in theft of 49 items (including 60 HP Expeller Motors – 2 No, 75 HP Expeller Motors – 3 No, Compressor motor – 1 No. etc) from Mammom unit in September 2003. There is also a risk of assets becoming obsolete due to disuse / lack of maintenance.

In view of this, it is recommended that the Company may:

- Maintain complete and up-to-date records of all movable and immovable assets;
- Periodically reconcile the discrepancies in the figures of the assets ;
- Conduct physical verification of assets at regular time intervals;
- Make adequate security arrangements for immovable properties so as to prevent possibilities of encroachments;
- Make adequate arrangement for upkeep / maintenance of disused assets and periodically review the position for their future utility;
- Obtain regular and adequate insurance cover for all the assets against risks;
- Clear back log in finalisation of accounts since 1996-97; and
- Dispose of movable assets valuing ` 0.15 crore.

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[35] **Edappally: 3.59 acres, Elathoor:1.48 acres, Thiruvangoor:10.79 acres and Mammom: 5 acres.**

Government/ Management replied (August / June 2010) that the list of movable and immovable assets had been prepared and their physical verification would be conducted as per the laid down policy. Besides, action is being taken for giving adequate insurance coverage for all the assets and adequate arrangements are there to prevent encroachment. The Company has accepted the facts that the original asset register is not available and hence the original cost of the assets, depreciation and technical specifications of machinery etc., cannot be identified.

Thus in the absence of original record of assets, all future exercises would be futile. It has also been appraised that the accounts of the Company upto 2007-08 have been approved by the Board and handed over to the Statutory Auditors for auditing**.**

Statutory Corporations

Kerala State Electricity Board

4.9 Avoidable loss of revenue

Providing incorrect estimated figures of consumptions instead of actuals in respect of EHT / HT / LT consumers for fixation of tariff to KSERC resulted in avoidable loss of revenue of ` 2.52 crore during July 2008-September 2008 and also earned unintended revenue of ` 12.67 crore during October 2008-April 2009.

Based on a petition filed (July 2008) by the Board to overcome the critical power situation prevailing in the State, Kerala State Electricity Regulatory Commission (KSERC) sanctioned (July 2008) restriction of power consumption of HT / EHT consumers with effect from 25 July 2008 to 75 *per cent* on monthly basis, calculated reckoning average monthly consumption from 1 April 2007 to 31 March 2008. Any consumption over and above the quota so fixed shall be charged at the actual cost of additional purchase required, calculated on a monthly basis and rates for additional usage of preceding month should be got approved by the Commission before 5th of each month. It was further clarified (August 2008) by the Commission that cost of power for excess consumption shall be calculated by taking weighted average rate of all stations which provide power in merit order operation[36] (including Unscheduled Interchange (UI) and power purchased from traders). Subsequently, the Commission approved (October 2008) introduction of power restriction to LT consumers also with effect from 15/10/2008 and the restriction on power for both LT and HT / EHT was reduced to 20 *per cent*. The restriction was withdrawn with effect from 1 May 2009.

As the tariff rate for additional consumption was worked out based on weighted average cost of supplies from all thermal power stations received on merit order

[36] **In the order of higher rated purchases from thermal power stations.**

operation, the more the figure of actual consumption given by the Board lesser would be the rate approved by the KSERC and vice versa.

We observed that even though actual figures of consumption by EHT / HT consumers were available, the Board while submitting proposals to KSERC for fixation of rates for consumption in excess of quota adopted estimated consumption by EHT / HT consumers (July 2008-September 2008) which were on the higher side which resulted in revenue loss of ` 2.52 crore (***Annexure 28***).

Board stated (May 2010) that the actual status of excess consumption was known only after raising the invoices for excess consumption. Therefore, the Board proposed to fix the rate for excess consumption based on the estimated figures. It was further stated that rates as per actual figures compiled subsequently, for the period October 2008 to April 2009 were less than the estimates and therefore, Board made excess collection of ` 10.15 crore.

The reply will not hold good, as the actual figures of consumption of EHT / HT consumers was available with the Board at the time of giving monthly proposals to KSERC and estimated figures of monthly excess consumption given to KSERC during the period October 2008 – April 2009, when quota system was applicable to LT consumption, were lesser than actuals, ranging from 4.71 *per cent* to 52.43 *per cent* (excluding April 2009). This resulted in fixation of higher rates than actually required under merit order system, leading to excess collection from EHT / HT (` 5.09 crore) and LT (` 7.58 crore) consumers, amounting to ` 12.67 crore (***Annexure 28 and 29***). The fact remained that adoption of incorrect estimated figures which were lesser to the actual consumption provided to KSERC for EHT / HT / LT consumers (October 2008 – March 2009) resulted in unintended revenue of ` 12.67 crore to Board. Thus, the Board made overall net additional revenue of ` 10.15 crore.

The matter was reported to Government in April 2010; their reply is awaited (September 2010).

4.10 Loss of Savings

Lack of system for ascertaining prevailing market prices and non-synchronisation of fresh tender during the delivery period of additional quantity resulted in loss of savings of ` 1.10 crore.

The terms and conditions of purchase orders for procurement of substation equipments, line material, spares, etc., issued by the Board contained a stipulation that supplier should provide an additional quantity of 25 *per cent* in excess of quantity ordered, at the same rates, terms and conditions if called upon to do so. Purchase orders issued for such additional quantity, stipulated that prices will be refixed if fall in prices occur in the next tender during the delivery schedule fixed for the additional quantities. The intention of the Board in including such a clause was that, in the event of reduction in prices during the scheduled delivery period, the savings should accrue to the Board's account. During test check, we noticed (April 2010) that the Board did not ensure that

fresh tenders are invited during the delivery period of additional quantity to avail the benefit of falling prices.

The Board issued 11 purchase orders for additional quantities during 2007-09. In six cases, there was an increase in prices and the same was paid as per the conditions on price specified in the original purchase order. Out of the remaining five cases, where there was reduction in prices the Board could not avail the reduced prices in two cases because the tenders were invited immediately after the period of supply of additional quantities. In three cases although the tenders had been invited during the currency of the delivery period, these were opened only after the delivery period thereby impeding the possibility of refixation of price as indicated below:

Sl No	Purchase order No, date and name of supplier	Material	Date of completion of supply	Date of next tender	Date of opening of tender	Saving forgone (` in lakh)
1	TCM/49/2008-09/1371 dated 4.7.07 Traco Cable Company Ltd, Kochi	ACSR Dog conductor	13 August 2007	20 August 2007	25 January 2008	10.97
2	TCM/69/2008-09/1801 dated 18.7.08 SBEE, Cables India Limited, Bangalore	1100 V Grade control cables of different sizes	1 September 2008	31 October 2008	20 March 2009	39.82
3	TCM/108/2008-09/2570 dated 29.08.2008 Megwin Switchgear (P) Limited, Salem	11 KV 10 panel (4 sets) with spares	27 October 2008	23 September 2008	02 February 2009	18.66
4	TCM/78/2008.09/25750 dated 28.07.08 Areva T&D India Limited, Chennai	110KV, SF6 Circuit Breakers excluding erection &commissioning	3 October 2008	17 September 2008	30 January 2009	28.53
5	TCM 127/2008-09/2863 dated: 15.09.2008 G.R Power Switchgear Limited, Hyderabad	110 KV Insulator with structure	4 January 2009	4 December 2008	15 April 2009	11.59
	Total					**109.57**

The schedule of tendering for next purchase was not synchronized with the delivery of quantity as per the additional order for 25 *per cent* so as to ascertain the prices and invoke the refixation clause; thereby the opportunity for savings amounting to ` 1.10 crore was lost.

Management stated (July 2010) that according to purchase procedure, purchase plan is prepared for a year based on requirements, by preparing a priority list for inviting tenders based on the availability of materials, taking into consideration

stock, pipeline quantity, tenders under process and 25 *per cent* additional quantity to be given etc., with the approval of purchase committee. Hence it is practically very difficult to arrange a fresh tender within the delivery schedule of additional quantity in order to make use of the provision for refixation. Government endorsed (August 2010) the views of Management.

The reply will not hold good as the Board had included the provision for refixation of prices, with the intention of making the savings due to reduction in prices, during the intervening period, knowing very well the purchase procedure hitherto followed. In the instant cases, the date of next tender was within seven and 60 days of delivery date in serial numbers 1 and 2 and serial numbers 3 to 5 was within the delivery period. The Board was very well in a position to synchronise the timing of fresh tender with the delivery period of additional quantity in these cases and lost an opportunity for savings amounting to ` 1.10 crore.

We suggest that Board should synchronise their procedure for purchase of additional quantity in such a manner that the benefit of reduction in prices could be reaped.

4.11 Short realisation of electricity charges

Failure to include penal provision for excess consumption in respect of two licensees in the tariff revision proposals submitted to the Kerala State Electricity Regulatory Commission resulted in revenue loss of ` 0.48 crore.

The Kerala State Electricity Board (Board) engaged in the generation / purchase and distribution of power, had to obtain prior approval of the Kerala State Electricity Regulatory Commission (KSERC) for implementing tariff revision in terms of section 61 of The Electricity Act, 2003. The revised tariff shall be applicable to all its consumers superceding all previous tariff regulations / rules and agreements entered into with them by the Board / Government in this respect. Based on the proposal of the Board, KSERC approved (November 2007) tariff revision to all its consumers with effect from 1 December 2007.

As per the tariff notification, the billing demand for High Tension (HT) or Extra High Tension (EHT) consumers shall be the recorded maximum demand for the month or 75 *per cent* of contract demand (as per the agreement) whichever is higher. When the actual maximum demand in a month exceeds the contract demand as per the agreement, the excess demand shall be charged at a rate of 150 *per cent* of the demand charges applicable.

We observed (June 2009) that, there was no provision in the schedule of tariff and conditions for bulk supply to licensees who avail energy through HT or EHT systems at their terminal for charging penal rate for consumption in excess of contract demand. According to the monthly invoices of Board, the power consumption by three licensees viz., Thrissur Municipality (contract demand 8000 KVA), Electricity Department, Pondicherry (contract demand 3300 KVA up to May 2009 and 5500 KVA from June 2009) and Karnataka Electricity

Board[37], Madikery (contract demand 100 KVA) was in excess of their contract demand. The excess consumption of power ranged between 38 KVA and 12626 KVA (Thrissur Municipality) 80 KVA and 2553 KVA (Electricity Department, Pondicherry) and 6 KVA and 139 KVA (Karnataka Electricity Board, Madikery) during December 2007 to September 2009 but was invoiced at normal tariff rates only. This resulted in short collection of electricity charges from two licensees operated from outside the State (Electricity Department, Pondicherry and Karnataka Electricity Board, Madikery) amounting to ` 0.48 crore for the period December 2007 to July 2010 (***Annexure 30***).

Board, in interim reply, stated (June 2009) that penalty will be charged if such a condition is incorporated in the agreement executed between the licensees and the Board. Since the copies of the agreement executed between the licensees and the Board was not available with them as these licensees were old ones, they were not in a position to charge penalty for the demand in excess of contract demand.

The Board has been working on loss and the deficit is treated as Revenue gap / Regulatory asset in its accounts since 2006-07, which should be recovered in a time bound manner. Despite this, the Board did not consider charging penalty for excess consumption by licensees while furnishing tariff revision proposal to KSERC foregoing opportunity to improve its financial position. Further, the preferential treatment of licensees would ultimately result in putting burden on other consumers while implementing tariff revision. KSERC also could not consider this vital issue like in the case of other HT / EHT consumers due to the flawed tariff proposal of the Board.

We suggest that the Government / Board should take necessary action to enter into fresh agreement to abide by the schedule of tariff and terms and conditions for retail supply by KSEB.

The matter was reported to Government / Board (May 2010); their replies are awaited (October 2010).

General

4.12 Follow-up action on Audit Reports

Explanatory notes[38] outstanding

4.12.1 The Audit Reports of the CAG represent the culmination of the process of scrutiny starting with initial inspection of accounts and records maintained in the various Government Companies and Statutory Corporations. It is, therefore, necessary that they elicit appropriate and timely response from the executive**.** Finance Department, Government of Kerala issued (April 2005) instructions to all Administrative Departments to submit explanatory notes indicating a

[37] Now Bangalore Electricity Supply Company Limited.

[38] Explanatory notes refer to the explanations furnished by Administrative Departments to the Legislature Secretariat, on reviews / paragraphs contained in Audit Reports placed before the Legislature.

corrective / remedial action taken or proposed to be taken on paragraphs and reviews included in the Audit Reports within two months of their presentation to the Legislature, without waiting for any notice or call from the Committee on Public Undertakings (COPU).

The Audit Reports for the years up to 2008-09 have been presented to the State Legislature but ten departments did not furnish explanatory notes on 53 out of 138 paragraphs / reviews relating to the Audit Reports for the year 2004-05 to 2008-09 as of September 2010.

Compliance to Reports of Committee on Public Undertakings (COPU) outstanding

4.12.2 As per the Handbook of Instructions for Speedy Settlement of Audit Objections issued by the State Government the replies to paragraphs are required to be furnished within two months from the presentation of the Reports by COPU to the State Legislature. Action Taken Notes (ATNs) to 341 paragraphs pertaining to 89 Reports of the COPU presented to the State Legislature between July 2000 and July 2010 had not been received as of September 2010 as shown below:

Year of the COPU Report	Total number of Reports involved	No. of paragraphs where ATNs not received
1998-2000	2	13
2001	2	6
2001-2004	10	47
2004-2006	18	54
2006-2008	28	118
2008-2011	29	103
Total	**89**	**341**

Response to inspection reports, draft paragraphs and reviews

4.12.3 Audit observations made during audit and not settled on the spot are communicated to the heads of the PSUs and the concerned departments of the State Government through Inspection Reports (IRs). The heads of PSUs are required to furnish replies to the IRs through the respective heads of departments within a period of six weeks. IRs issued up to March 2010 pertaining to 79 PSUs disclosed that 2,212 paragraphs relating to 462 IRs remained outstanding at the end of September 2010. Of these, 53 IRs containing 403 paragraphs had not been replied to for one to four years. Department-wise break-up of IRs and paragraphs outstanding as on 30 September 2010 is given in ***Annexure 31***.

Similarly draft paragraphs and reviews on the working of PSUs are forwarded to the Principal Secretary / Secretary of the administrative department concerned demi-officially seeking confirmation of facts and figures and their comments thereon within a period of six weeks. It was, however, observed that five draft paragraphs and two draft reviews forwarded to various

departments during April-July 2010 as detailed in ***Annexure 32*** had not been replied to so far (September 2010).

It is recommended that the Government should ensure that (a) procedure exists for action against the officials who fail to send replies to IRs / draft paragraphs / reviews and ATNs on recommendations of COPU as per the prescribed time schedule, (b) action is taken to recover loss / outstanding advances / overpayment in a time bound schedule, and (c) the system of responding to audit observations is revamped.

Thiruvananthapuram **(K S SUBRAMANIAN)**
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Countersigned

New Delhi **(VINOD RAI)**
The **Comptroller and Auditor General of India**