CHAPTER II: MINISTRY OF DEFENCE

2.1 Undue favour to a foreign vendor in procurement of fleet tankers

Fleet tankers being constructed by a foreign vendor did not meet the specifications of the steel as envisaged in the RFP. Commercial negotiations with a foreign vendor for procurement of a fleet tanker, despite being protracted and delayed, did not take into account the quality of steel offered by the vendor. Excess provisioning of spares of Rs 30.44 crore and under realisation of offset benefit to Indian industry were also noticed in the procurement of the tanker worth Rs 936 crore.

In order to maintain its approved force levels, Indian Navy's Ship-building Plan envisaged addition of two fleet tankers (tanker) by 2008 and 2011 respectively. Accordingly, a Request for Proposal (RFP) was issued to 12 firms in November 2005. In response to the RFP, only three firms responded, namely M/s Rosoboronexport, Russia (ROE), M/s Hyundai Heavy Industries Limited (HHIL) and M/s Fincantieri, Italy.

The RFP included a mandatory condition in the technical specifications for the tanker that DMR 249A / or equivalent grade steel be used in the construction of the hull of the vessel. DMR 249A is a high quality steel used for naval applications with specific weight and resilience qualities. The steel is almost double the cost of ordinary steel.

Out of the three firms, only ROE offered a technical proposal for using DMR 249A/ or equivalent steel. The offer of HHIL was rejected due to non-compliance with RFP provisions which included non-usage of DMR 249A steel. Fincantieri's proposal was stated to be compliant with the RFP conditions. However, the firm proposed to use DH 36 steel in place of DMR 249A steel.

The Technical Evaluation Committee (TEC) asked Fincantieri to provide justification for selection of DH 36 grade steel. In its justification, the firm stated that (i) sourcing DMR 249A steel was a problem, (ii) ordinary steel is normally used for tankers and (iii) high resilience performance of DMR 249A is not necessary for this ship. According to the firm's own admission, DH 36 grade steel has less weight and less resilience when compared to DMR 249A.

The chemical compositions of DH-36 grade steel and DMR 249A steel are different and they cannot be treated as equivalent to each other. The prices of these two grades of steel are also different in as much as DMR 249 A grade is more expensive than DH-36 grade steel. Incidentally, ***all*** three bidders had, in their offers, stated that usage of DMR 249A was affected by high costs and restricted sourcing but the usage could be considered subject to price adjustment.

Nonetheless, the TEC opined that the DH 36 steel was equivalent to DMR 249A grade steel and accepted the technical bid of Fincantieri without taking cognizance of the offer made by the other two bidders. The Technical Oversight Committee also recommended the offer of Fincantieri.

Later, when the commercial bids were opened, Fincantieri emerged as L1 (lowest bid) with a quote of Rs 723 crore. The offer of ROE was rejected as it was costlier, being based upon the prices of DMR 249A / or equivalent steel. The Commercial Negotiation Committee (CNC) used two models of costing to establish reasonableness of prices. In the first, the L1 cost was compared with that of a fleet tanker built indigenously between 1987 and 2000. The CNC after taking into account various factors worked out a figure of Rs 733.55 crore. This model used the prices of DMR 249A steel for estimating the cost of the vessel. The CNC also carried out an analysis of the break-up of costs provided by Fincantieri even though the break-down of the main elements of the cost of a vessel, i.e. labour and material, could not be used to compare the cost of the foreign-made vessel with the cost of the indigenous tanker The foreign vendor had high labour rates but used lesser number of manhours on account of automation in construction. Also, cost of yard material, including DH-36 could not be estimated.

In the second model, the CNC used a quotation from Hindustan Shipyard Limited (HSL) of Rs 350 crore in 2004. The CNC after adding the escalation factors decided on the reasonable price of Rs 730 crore and used it as a justification in favour of the bid of Fincantieri of Rs 723 crore. This model escalated the HSL estimate based on DMR 249A steel although Fincantieri had based their commercial bid on the cheaper DH 36 steel. The entire exercise was, thus, vitiated since it was based upon two different grades of steel.

Notwithstanding these flaws in the tendering process, in April 2008, Government sanctioned the acquisition of a fleet tanker from Fincantieri, at a cost of Euro 159,326,750 (Rs 936.04 crore[1]). The contract[2], concluded in the same month, with the shipyard envisaged delivery of the tanker by April 2010 and also had provision for purchase of one more tanker under an option clause. A separate contract for offset was also concluded in April 2008 for Euro 41,563,500.

It was observed that the cost of Base and Depot (B&D) spares was negotiated post-evaluation of the quotations received, thereby; passing an undue benefit to the supplier since the B&D cost was not made a part of the commercial offer. The quantum of B&D spares was agreed at 15 *per cent* of the basic cost of the ship. While computing this amount, the entire value of the ship, i.e. Euro 138,545,000 inclusive of weapons and other services, was taken rather than just the basic cost of the ship. As a result, there was excess provisioning of B&D spares to the tune of Euro 5,181,750 (Rs 30.44 crore). Delinking the B&D spares from the commercial offer had a fall-out on the offset contract as well. The Defence Procurement Procedure (DPP) prescribes an offset clause at a minimum of 30 *per cent* of the cost of the acquisition. However, Ministry concluded the offset contract for Euros 41,563,500 by taking 30 *per cent* of the basic price of the ship (Euros 138,545,000) excluding the cost of B&D spares on the grounds that offset is to be calculated on the commercial proposal. Audit noted that while taking the approval of the CFA, the total cost of acquisition was made up of the basic cost of the vessels and the B&D

1 1 Euro = Rs 58.75
2 Price of ship: Euro 138,545,000; Base and Depot spares: Euro 20,781,750

spares. Resultantly, it led to under realisation of offset benefits to Indian Industry.

In March 2009, Government accorded another sanction for acquisition of one more fleet tanker from the same firm, at the same price, under the option clause. The RFP had envisaged that the option clause would be valid for 18 months post conclusion of contract. However, because of the delay in negotiations and conclusion of contract, the CNC was forced to accept the vendor's proposal that the option clause be exercised 18 months from the date of offer of the lowest firm. Thus, the option clause which was to remain in force for 18 months from April 2008 came into force from September 2007. Hence, Navy was forced to exercise the option as a ***fait accompli*** and ordered another tanker even before receiving/evaluating the equipment originally contracted for.

The Ministry stated in, October 2009, that the process of awarding contract for construction of the fleet tanker to the foreign vendor was carried out by providing a level playing field and within the provisions of RFP. The material cleared for use on the tanker is not inferior and is of a desired quality as required for a Navy tanker. Ministry defended the offset contract by stating that the DPP specifies that the offset percentage is to be based on the commercial proposal.

The reply of the Ministry is not tenable as the tankers being procured are not made from the requisite type of steel viz. DMR 249A as envisaged in the RFP but by using DH 36 grade steel suggested by Fincantieri. The equivalence of this steel was not established independently. Ministry's argument with respect to the offset is not acceptable as the RFP itself did not specify that B&D spares should be quantified.

2.2 Import of radars by a PSU against indigenous manufacture order

Approval of the Competent Financial Authority was obtained by the Ministry for supply of 22 SREs under Phase II to IAF by BEL citing its capability to manufacture these radars indigenously. However, BEL violated the intent of CFA by procuring 60 *per cent* radars in CKD form from the OEM at a lower cost. As a result, BEL had unwarranted additional returns of Rs 10 crore. Supplying CKD radars instead of indigenously manufactured ones also resulted in premature delivery before finalisation of works services.

Ministry of Defence (Ministry) concluded a contract with Bharat Electronics Limited (BEL) in March 2003 for procurement of 20 Surveillance Radar Element (SRE radars) from an Italian firm (M/s SELEX), the Original Equipment Manufacturer (OEM)), in Phase I at a total cost of Rs 585 crore excluding works services. Under this contract, BEL was to obtain 12 radars from the OEM and supply them to Indian Air Force (IAF) sites. The balance eight radars were to be indigenously manufactured (IM) after obtaining Transfer of Technology (ToT) of the equipment from the OEM. Delay in installation of the radar against 2003 contract has been commented in paragraph 2.1 of CAG's Report No. 5 of 2007.

In July 2007, the Competent Financial Authority (CFA) approved procurement of 22 SRE radars in Phase II from BEL at the cost of Rs 870 crore. The total cost included the works services component of Rs 137 crore at the installation sites. In turn, Ministry of Defence entered into a contract with BEL in September 2007 for the supply of indigenously manufactured radars. BEL was given the order by the Ministry under special dispensation of the Defence Procurement Procedure 2005 (DPP) as the procurement was categorised as 'MAKE' and a repeat order by the Defence Acquisition Council (DAC) on the premise that BEL would be able to manufacture the radars indigenously as they had absorbed the technology transferred from the OEM in Phase I. Though it was cheaper for the Government to purchase the fully furnished radars from the OEM directly, it was a considered decision of the Government to involve BEL in the procurement process in order to achieve self reliance. The cost of self reliance endeavoured to be achieved was Rs 41.39 crore. BEL, however, did not manufacture the radars indigenously under Phase II. Audit found that within three months of getting the Ministry's order, BEL placed a follow-on order on the OEM, in December 2007, for import of nearly 60 *per cent* of the radars (13 out of 22 ordered) in CKD[3] form along with spares and 22 sets of assembly kits at a cost of Euro 52 million, in gross violation of its own commitment of manufacturing these radars indigenously. Not only was the sanctity of the Defence Procurement Procedure violated by BEL but the intent of the CFA approval was also flouted.

The negotiated price for the Phase II supplies of SRE was based on the indigenised product (IM modules) of 2003 supplies, whose cost was higher than those of imported products (Rs 0.78 crore per radar) whether in SKD[4] or CKD form. Since BEL purchased the CKD kits of radars in December 2007 from the OEM at lower prices than the prices taken from the Government for indigenously manufacturing these radars, it earned greater returns than those negotiated and agreed with the Ministry. This enabled BEL to carry an additional amount of Rs 10.14 crore over and above the profit already allowed to it.

It was also noticed in audit that though five radars were delivered by BEL prematurely, required work services to install the radars were not completed by them as of June 2010. As a result, the early delivery of radars did not yield any benefits to IAF.

Ministry, in February 2010, accepted the audit observation that 13 SRE radars out of 22 are assembled from a CKD kit rather than manufactured indigenously and the issue was being examined in consultation with the concerned administrative wing of Department of Defence Production. It also admitted a gap between the receipt of SREs and the works services. However, Ministry argued that the additional benefit of Rs 10.14 crore was not correct as prices were based on material procurement by BEL in 2005-06 and their value addition in 2007-08.

[3] Completely Knocked Down
[4] Semi Knocked Down

Ministry's reply is not acceptable with reference to the unwarranted benefit as BEL purchased the CKD kits in 2007 at prices prevailing in 2003. Thus, the base price used by Ministry was already higher by the original difference between IM manufacture and CKD kits.

2.3 Irregular commercial exploitation of Santushti Shopping Complex

Delay in revision of licence fee and irregular crediting of revenue to non-public fund by IAF authorities in violation of Ministry's directives and Government orders has deprived the exchequer of revenue amounting to Rs 9.75 crore approximately. Further, the Ministry's decision to suspend the eviction process without taking any action for more than two and a half years has allowed unauthorised occupants to retain possession of these shops for more than 13 years.

The Santushti Shopping Complex (Complex) was established in 1985 by the Air Force Wives Welfare Association[5] (AFWWA) at Air Force Station (Station), Race Course, New Delhi primarily to assist Service personnel by providing income / employment opportunities through allotment of shops to selected categories of personnel / their families. In March 1998, management of the Complex was handed over by the Ministry of Defence (Ministry) to the Defence Estate Officer (DEO). However, in August 2006, management of the Complex reverted to Air Force Station authorities.

Unauthorised construction/ modification of an existing defence building and its conversion into a shopping complex by Air Force authorities and crediting substantial revenue into Non-Public Fund (NPF) *inter alia* was commented upon in paragraph 18.5.1 (a) of the Report of the Comptroller & Auditor General of India for the year ended 31 March 1996. Further, during the last 15 years, various authorities like the CGDA[6], Joint Secretary (APO&W[7]) and a High Powered Committee have through special audits / enquiries found various irregularities being committed by Air Force authorities in the running

[5] A welfare organization set up in October 1970 as a registered body for providing assistance to the families of deceased/disabled/retired/serving personnel of the Indian Air Force.

[6] Controller General of Defence Accounts

[7] Joint Secretary (Army Purchase Organisation and Works)

of the Complex. One of the issues highlighted was the irregular commercial exploitation of the Complex to exclusive advantage of a non-government body, viz. AFWWA. In response to CGDA's internal audit report, Ministry had directed (October 1995) that since allotment of land at concessional rates for exploitation for commercial purposes was illegal, the entire proceeds realized/realizable by way of rent, rebate etc. from the premises should be deposited into government account, no rebate or any other dues realized from the premises should be deposited in any non-government fund and if the property was to be let out to private persons, it should be on commercial rates, which were to be settled by competitive bidding/auction.

The Government issued orders in January 2001 for crediting revenue realized from shopping complexes on Defence land to the Government account. The Government further issued Rules of Management of such complexes in November 2002 and June 2006. Despite these directives and orders, audit found that 50 *per cent* of the revenue earned during the period from August 2006 to June 2009, amounting to Rs 2.56 crore, had been deposited by Air Force authorities with the Regimental Funds of the Air Force which is a non-government fund. In comparison, during the period from March 1998 to August 2006 when the management of the Complex was with the DEO, the amount earned was Rs 12.12 crore which was deposited with the Government treasury. Incidentally, during this entire period (March 1998 to June 2009), Rs 4.88 crore was spent on maintenance of the Complex by deducting this amount from the revenue earned.

The Complex houses 43 shops, which are leased out to various allottees at a specified rate of license fee. As per the Rules of Management framed in 2002 and 2006, 60 *per cent* of the shops were to be reserved for (i) war widows/widows of defence personnel killed while on duty, (ii) disabled soldier, (iii) ex-servicemen and (iv) spouses/widows of ex-servicemen, and the remaining 40 *per cent* of the shops could be allocated to Government agencies including Public Sector Units and civilians whose spouse or dependent family members do not own any shops in the Complex/ Military station/ Cantonment. It was noted that as of February 2007, out of the 37 shops which were allotted on that date, only 11 shops were allotted to the defence category. This amounted to 30 *per cent* as against the requirement of 60 *per cent*. Four shops *did not actually* fall in the categories enumerated above as three shops were allotted to relatives of ex-serviceman and one shop to AFWWA. The remaining 22 shops were also allotted to high-profile civilians mentioned in Annexure-II. After the allotment of the six vacant shops in 2008, the percentage of shops allotted to persons with defence background increased to 37 *per cent* although 22 shops continue to be leased to civilians.

Initial allotments made by AFWWA were through annual agreements which were renewed annually with or without revision of lease rent. In March 1998, when the management of the Complex was handed over to the DEO, license agreements of all shops had already expired during 1996-98. Subsequently, when the management reverted to the Air Force Station, the Station Authorities in pursuance of Rules of Management of 2002 and 2006[8] issued eviction notices (September 2006) after more than a decade to every shop owner to vacate the shops. Further, the occupants were granted a period of six months to vacate the premises. During this six months period, licence fee at the existing rates was to be charged. In the meanwhile, Santushti Entrepreneurs Association (SEA), however, gave a representation against the eviction notices to the Raksha Mantri (RM). Ministry, in March 2007, conveyed directions that till a final decision on the representation was taken, the existing occupants were not to be disturbed. Audit noted that the SEA made representations to the RM four times[9]. On each occasion, eviction proceedings were kept in abeyance. This has allowed unauthorised occupants to retain possession of these shops for more than thirteen years since 1997 despite eviction notices and without having valid agreements.

Meanwhile, the Station Authorities also initiated action for revising the license fee for shops by constituting a Board of Officers (Board) first in October 2006 and subsequently in November 2007. The licence fees prevailing were without any uniform criteria and varied at Rs 50[10], Rs 120[11] and Rs 170[12] per square feet per month. The Board of November 2007 adopted a rate of Rs 85 per square feet, after adding 10 *per cent* inflation for two years to a rate

[8] As per these rules, unauthorized occupants, whose allotment period/license had already expired on or before the date the management of the shopping complex was transferred to the Military authority, might be allowed, on request, six months to vacate the premises.

[9] 7 December 2006, 31 January 2007, 17 August 2007 and February 2008

[10] 28 shops paid Rs 50 from 1991onwards

[11] 06 shops paid Rs 120 from 1997 onwards

[12] 02 shops paid Rs 170 from 1998 onwards

given by the New Delhi Municipal Authority (NDMC) for the year 2005. The Board ignored a rate given by the CPWD (Rs 124.84 per *sq. ft*), which had been framed as per the Rules of Management 2002, on the grounds that the CPWD rate was much higher. This also implied that even the eight shops which had been paying rates of Rs 120 and Rs 170 would be paying lower rates in future. Though the complex is located in a prime area, surrounded by five star hotels, none of the agencies preferred to call for competitive bids for the shops to determine the market rent.

The Board further recommended that the existing rate be maintained for the current occupants till a decision on their tenancy was taken by the Ministry. This was because any increase in the licence fee would have involved a fresh agreement, which would legitimise their possession of the shops. Thus, as a result of delay in revising the licence fee coupled with non-adoption of CPWD rates and the Board's recommendation to maintain the existing rate pending Ministry's decision, the exchequer has suffered a revenue loss of Rs 7.19 crore approximately during the period 2003 to September 2009 in the case of 37 shops.

Scrutiny of the income earned by the Complex on account of rent etc., showed that despite many of the shop-owners being defaulters, they were allowed to continue operating from the premises. There were long outstanding dues amounting to Rs 46.99 lakh against the shop owners of Santushti Complex on account of charges for damage of shop occupation and electricity charges during the period 1998 to 2006 which were communicated by the Station authorities to 25 shop owners in September 2006. However, only three shops paid their arrears and arrears remain outstanding for more than three years in case of the remaining shops.

The matter was referred to Ministry in October 2009; their reply was awaited as of June 2010.

2.4 Undue benefit to HAL on account of pricing policy

Notwithstanding Government instructions to the effect that no budgetary support for wages increase would be provided separately and that resources for funding the increased cost on account of wage revision have to be generated by the company internally, IAF reimbursed arrears on account of wages and gratuity to the extent of Rs 315 crore. Further due to delay in revision of the base year, IAF suffered an extra expenditure of Rs 400 crore.

Hindustan Aeronautics Limited (HAL) provides a wide range of supplies and services to the Indian Air Force (IAF) which includes manufacture/ major repair/overhaul of aircraft/helicopters and its aero-engines and supply of maintenance/overhaul spares. From August 1995, HAL follows a Fixed Price Quotation (FPQ) Policy for the pricing of the supplies and services made to IAF. As per the FPQ policy, the base year prices were to be escalated annually up to 1999-00 at a pre-determined rate and 2000-01 was to be considered as the new base year. This was subsequently extended to 2001-02 on HAL's request. In August 2001, Ministry set up a Pricing Policy Review Committee (PPRC) to finalise, *within three months*, the standard terms and conditions of contracts, man-hour availability, labour efficiency / productivity levels at various HAL Divisions and overall cost reduction etc. The Report of the committee was submitted in June 2006 and approved in August 2006. Government sanctions were issued in October/November 2007 approving the base year price of 2004-05 for all the divisions with annual escalations to be applicable up to 2008-09.

I Extra expenditure due to delay in revision of base year

The delay in setting up of the PPRC and inordinate delay in finalisation of its report by more than four and a half years as against the prescribed period of three months, resulted in change of base year from 2000-01 to 2004-05, thus, allowing HAL to claim payments up to the year 2003-04 through simple escalation since Government sanction for approved prices for base year 2004-05 was issued only in October/November 2007. The delay in revision of base year by four years, thus, resulted in extra expenditure of Rs 400 crore approximately at the rate of Rs 100 crore annually to IAF for the year 2000-01 to 2003-04.

In their reply to audit, Ministry stated (May 2009) that no undue benefit had been given to HAL on account of delay in finalisation of the base year review and finalisation of the PPRC report. Ministry's reply is not acceptable to audit as the benefit of increased productivity by way of improved 'yield' (3.20 *per cent*) and 'efficiency' (6.89 *per cent*) was passed on to IAF from 2003-04 due to delay in revision of base year. The monetary value of this increased productivity was approximately Rs100 crore per annum. Further, IAF paid a higher Man Hour Rate from 2000-01, with the increase ranging from 15.92 to 17.62 *per cent*. It was noted that the delay in revision of base year was due to HAL`s reneging on the agreement for review of base year and not making data available even after the decisions were taken by the PPRC. In fact, HAL was in favour of continuing the existing base price escalation with moderate escalation rates. However, audit noted that IAF had opposed HAL's view-point since, in their opinion; there was a strong case for revision of base year in view of the adverse financial implications for IAF. IAF also felt that HAL should be subjected to detailed verification of records. The fact remains that there has been inordinate delay in finalisation of the report because of HAL, resulting in change of base year from 2000-01 to 2004-05 which lead to extra expenditure for IAF / Government.

II Payment on account of wage revision

As per a Memorandum of Understanding approved by the Government between the workmen and the management of the HAL, resources to meet the increased cost which would arise on account of the Wage Agreement had to be generated by (i) ensuring uniform production by all divisions of HAL and (ii) by improving productivity, in conformity with conditions laid down by Government in 1999 to the effect that any increase in wages after negotiations would not result in any increase in administered prices of their goods and services and in labour cost per physical unit of output. Despite these provisions, IAF contributed Rs 219.76 crore to HAL towards payment of wage revision arrears and Rs 95.17 crore on account of revision in gratuity for the period 1997-98 to 1999-2000. IAF also accepted an increase ranging between 15.92 to 17.62 *per cent* in the Man Hour Rate for the year 2000-01. Incidentally, IAF has not made any payment on account of wage revision to other Defence PSUs.

Ministry stated in December 2009 that payment of wage revision separately should not be viewed as budgetary support from Government but cost recoverable through customer which happens to be IAF. Ministry's reply contradicts Government's order that the wage revisions would be subject to the condition that there should be no increase in labour cost per physical unit of output. Therefore, increased cost on account of the Wage Agreement should not have been passed on to the IAF.

2.5 Unfruitful expenditure on submarine rescue facility

Inordinate delay in commissioning the Indian Navy submarine rescue facility, due to lack of adequate need assessment, poor planning and the absence of a conclusive time bound agreement with the United States Navy, is likely to render the facility unviable and expenditure of USD 744,343 thereon unfruitful.

Government of India in March 1997 sanctioned USD 288,008 for a submarine interim rescue facility tie up between the Indian Navy (IN) and the United States Navy (USN). The Indian Navy accordingly accepted (April 1997) a Letter of Offer and Acceptance (LOA) of USN for site survey for Submarine Rescue Service to enable supply and installation by the USN of holding devices required for mating the Deep Submergence Rescue Vessel (DSRV) and Submarine Rescue Chamber (SRC) of the USN with IN submarines. As per the LOA the case for rescue was recommended in two phases. The first phase was to cover a site survey, analysis of the submarines and facilities of IN to ensure rescue operation success and the second phase to include developing a separate case to support the actual rescue operation.

The USN submitted its initial report of survey in January 1998. Certain minor deficiencies identified by the USN were to be undertaken by the IN, after which the USN would give the final certification. The IN submitted the status report after four years in January 2002, intimating non availability of materials and technology for fitment and welding of Padeyes[13] on escape hatch of the submarines.

[13] Holding device for securing the DSRV to the submarine

Subsequently in February 2004, an additional amount of USD 446,435 was sanctioned by the Government of India expanding the scope of first Phase of LOA to include fitting and installation of supply support items. The LOA of April 1997 was, thus, amended and validated in March 2004 increasing the cost of the project to USD 734,443. The payments were to be made on a quarterly basis with the final payment of USD 113,853 scheduled for March 2005. Though the IN was aware of the poor progress and need to link at least future payments with proper milestones, the entire amount was paid by April 2005.

After a meeting held between IN and USN in October 2006, the USN agreed to provide its qualified technical team to install Padeyes on the first submarine and to train the IN welders to install Padeyes on the rest of the submarines. The IN welders were accordingly trained in November 2006. In June 2007, the IN sought requirement of welding rods to complete the fitment process for which an additional amount of USD 9,900 was paid to the USN. The additional rods were received by IN in August 2008. However, as of November 2009, the fitment of the Padeyes was in various stages of installation. Thus the first phase of the LOA for submarine rescue was yet to be concluded (December 2009).

Despite the expenditure of USD 744,343[14] (Rs 3.35 crore) incurred so far, on the project, which is yet to be completed even after 6 years of its signing, the utility of the project is questionable for the following reasons:

- 75 *per cent* submarines in the IN fleet have already completed three fourths of their estimated operational life. In fact the IN envisaged the project without clearly identifying deadlines for completing the project. It is pertinent to mention that only 7 out of 16 submarines in IN are operational and 9 submarines are under refit/repair as of October 2009. As of November 2009, Padeyes fitment has been completed in 11 out of 16 submarines out of which only 4 SSK[15] submarines have been certified by USN for mating with US DSRV for a period of three years effective from 20 December 2007 and of which

[14] 1 USD = Rs 45.05
[15] SSK is a Russian acronym which means “Diesel Electric Attack submarines”.

at least 2 are presently under refit. Two of the serving Foxtrot submarines, on which Padeyes were fitted, INS Vela and INS Vagli, would be de-commissioned in 2010 and 2011 respectively.

- The DSRV is to perform rescue operations on submerged or disabled submarines. It will remain stationed with the US Navy and in the event of an accident will be transported to the nearest seaport or airport, then to a mother ship to reach the rescue site. The nominal response time is 72 hours from the time the DSRV is lifted from its location to reach the rescue site and with the capability of rescuing up to a depth of 610 meters. Such time and depth restrictions further dilutes the effectiveness of a rescue facility which in any case is nowhere close to completion.

The matter was taken up by audit with the Ministry of Defence (Ministry), Government of India, New Delhi (May 2009). The Ministry in their reply (December 2009), while conceding to the point raised by Audit regarding delays in meeting the deadlines of the contract, attributed the delays mainly to imposition of sanctions, amendment of LOA in view of change in the scope of work, interpretation of contract differently by USN and other aspects concerning technology and operational incompatibility issues between IN and USN. The fact remains that despite the project having been envisaged in 1997, it is yet to be fully operationalised. There were flaws in conceptualisation and execution of the project in so far as time schedules were not laid down and payments not linked to work completed. Moreover, while the initial work of fitting of Padeyes and certification of IN submarines for mating with USN, DSRV was no where close to completion, a separate agreement with USN to enable DSRV to undertake rescue operations and further recertification of submarines is yet to be concluded.

Thus, lack of adequate need assessment, poor planning and the absence of a conclusive time bound agreement with the USN led to extensive delays in the timely commissioning of the essential and life saving submarine rescue facility.

2.6 Procurement of shipborne Electronic Warfare System

Expenditure of Rs 472 crore on import of seven Electronic Warfare Systems, considered critical for operational purposes, did not yield anticipated results due to delay at each stage of procurement.

Ministry concluded a contract in September 2003 with M/s Rafael, Israel for procurement of seven SEWS-V5 systems at a cost of USD 102,500,000 (Rs 472 crore[16]) with the first system to be delivered within 18 months from the date of contract and the remaining systems were to be delivered in another 18 months after successful completion of Sea Acceptance Tests[17] (SAT), which were expected to take about 3 months. Audit examination of the above procurement indicated the following:

- In August 1999, in order to overcome serious operational handicaps and enhance the Electronic Warfare (EW) capability of its ships, Navy proposed the priority procurement of ten Shipborne Electronic Warfare Systems (V5) (SEWS-V5) subsequently reduced to seven systems (February 2000) with a delivery schedule of 12 to 23 months. It was envisaged with the approval of the Raksha Mantri (April 2000) that the acquisition process from issue of Request for Proposal (RFP) to conclusion of contract would be completed in nine weeks. However, the competent financial authority (CFA) accorded approval for the foreign acquisition in August 2003.
- The process was delayed at each stage of procurement in general and, particularly, during the evaluation of commercial offers by the Price Negotiation Committee (PNC) as indicated below. The timeline of nine weeks given by RM was over-shot considerably and it took 176 weeks to finalise this contract as shown in the table:

[16] 1 USD = Rs 46.05
[17] Sea Acceptance Test means the tests to be carried out on the systems, while the ships are sailing on the sea

ACTIVITY	TIME PERIOD ENVISAGED	ACTUAL TIME TAKEN
Request for proposal	1 week	3 weeks
Receipt of technical and commercial offers	4 weeks	8 weeks
Evaluation of technical proposal and preparation of TEC report	2 weeks	6 weeks
Evaluation of commercial offers, work of PNC and finalisation of contract	2 weeks	159 weeks

Ministry took 17 months in concluding the contract after finalisation of price. Thus, the urgency shown in the procurement of the system did not seem to be reflected in the procurement process.

- Despite the urgent requirement, IN opted for the SEWS-V5 which had a large developmental portion and was not proven on the date of contract. Ironically, Navy, in 2000, while arguing for a single-tender procurement from Rafael had stated that the SEWS-V5 was an upgraded version of the 'C-Pearl' system already in service with the Navy and, thus, could be considered as a proven system. Nonetheless, the contract finally concluded was conditional as the vendor would supply the first system, prove its performance in respect of prescribed Qualitative Requirement (QR) parameters and only then would 'Go Ahead' be given for the supply of remaining six systems.

- Against the delivery period of 18 months, the first system was delivered in 25 months in November 2006. The Sea Acceptance Tests (SAT) of the first set was completed in December 2006, and the linked 'Go-ahead' for the remaining six systems was accorded in March 2007. The SAT of four systems was completed between April 2008 and November 2008. As on date (September 2009), the sixth and seventh systems are yet to be installed since the ships are under refit.

Incidentally, even while seeking the approval of the CFA for the acquisition Ministry had assured that the entire delivery[18] would be completed within 39[19] months as against which the supplier took 64 months. Thus, the equipment was actually commissioned and installed after a gap of four to six years from the planned date leaving the frontline ships of Navy vulnerable.

- At the time of conclusion of contract in September 2003, Ministry was aware of the fact that the indigenous system for which sanction was accorded in June 1995 for undertaking an EW programme "Ellora" would be available by 2004. A contract for manufacture and supply of four system was concluded with BEL Hyderabad in March 2004 at a cost of Rs 262 crore. Three systems were installed between September 2005 and December 2007 while the fourth is under installation.

Ministry, in February 2010, stated that the time line of nine weeks for the acquisition process from the issue of RFP to the conclusion of contract were not 'approved' but only 'envisaged'. Ministry also defended the delay by explaining that there was no benchmark available within the country to compare and assess the system, its price and other aspects. Further, payment terms, guarantees etc had to be deliberated and examined. Audit found the reply unacceptable as the nine weeks time was an explicit decision taken at a meeting chaired by the RM and attended by the Chief of Naval Staff and Defence Secretary.

To sum up, despite an on-going indigenous programme for development of EW systems, Indian Navy purchased seven imported systems at a cost of Rs 472 crore on the grounds of 'operational emergency'. Due to delay in procurement at each stage, these systems could not be made available to Indian Navy urgently, thereby, defeating the very purpose for which the priority procurement was proposed. By the time they were available and could be fitted onto the ships the indigenous systems were also developed and productionised.

[18] From issue of RFP to complete delivery of systems

[19] 18 months for delivery of first system, 3 months for installation and trial evaluation and 18 months for delivery of the remaining six systems

2.7 Inordinate delay in development of Air Bases

Despite sanctioning an additional Rs 25.17 crore for speedy completion of the project on fast track basis, frequent changes in plans led to a delay of over two decades in commissioning a strategic forward base airfield. In the second case, an airbase could not be activated and operationalised, even 25 years after obtaining government approval, for use by fighter aircraft.

The prevailing security scenario and emerging threats led IAF to obtain approval for developing two air bases at Phalodi and Thanjavur. Audit reviewed the execution of the two decisions and found considerable delay in their establishment and activation. Each case is discussed in brief below.

Case I: **Development of an Airfield at Phalodi**

Citing the increasing number of air-fields in a neighbouring country, in March 1985, the competent financial authority (CFA) approved construction of a Forward Base Support Unit (FBSU), in Phalodi (Rajasthan), at a cost of Rs 29.33 crore. Although the land for the FBSU was acquired in October 1986 at a cost of Rs 0.67 crore, actual construction could not commence as the budgetary support[20] earmarked was utilised for other urgent and operationally important requirements. After a gap of more than a decade, in January 2002, the proposal was once again put up to the CFA who accorded a revised approval for construction of a full-fledged airfield, instead of a mere FBSU. As a result of the increase in scope of work, the cost increased to Rs 227.38 crore. The Ministry / IAF also identified 23 works which were to be executed over a period of four years. Given the delays and urgency of the air-field, this cost included Rs 25.17 crore for undertaking the project on fast track basis. Nonetheless, despite approval in 2002, initial funds were released only in August 2004, i.e after a delay of 31 months, thereby defeating the very purpose of sanctioning the project on a fast track mode.

[20] 1985-86: Rs 29.33 crore
1988-89: Rs 78 crore
1989-90: Rs 2.28 crore

As of September 2009, only 15 sanctions worth Rs 123.88 crore have been accorded against the originally identified works services. Though certain facilities were essential for the development of an Air Force Station, no works have been sanctioned for them. Thus, important works, viz. OTM for Tropo Communication Unit and Mobile Observation Flight, provision of bomb dumps, Blast pens, etc are yet to be sanctioned.

Audit noted that, as of September 2009, expenditure of only Rs 85.86 crore has been incurred and the progress of the various works ranged between 45 and 100 *per cent*. The airfield runway has achieved a progress of 71 *per cent*. Tardiness in the completion of work was initially due to the location of the run-way not being finalised leading to a delay of two years in commencement of work although works services for construction of the runway were sanctioned in October 2005. In addition, frequent changes in the Master Plan necessitated revision of five administrative approvals. Besides, the delay has led to cost revisions as well. In eight out of the 15 sanctions, there has been a cost escalation amounting to Rs 25.38 crore.

Further, IAF, in March 2005, decided to exploit the existing bases with surplus infrastructure rather than increasing the number of air bases. It was, therefore, decided to slow down the rate of build up at Phalodi. Audit, however, found that although till March 2005 only five sanctions to the tune of Rs 23.35 crore had been issued, between June 2005 and December 2008 Air HQ accorded approval to ten sanctions worth Rs 100.53 crore including non-priority works. Less critical infrastructure like Officers Institute, Mess, shopping centre, bank, RO plant and guest-house were given priority over the main works required for creation of an airfield. Officers' Institute was also being constructed although the station did not qualify for the Officers Institute owing to inadequate strength of officers.

In the meanwhile, audit found that the IAF, in March 2007, was contemplating operations of helicopters only at Phalodi and no fighter aircraft were envisaged to operate from the base at present. As the proposal, initially mooted, was for the operation of fighter aircraft from the FBSU, the infrastructure created at a cost of Rs 22.12 crore, in keeping with the requirements of a fighter squadron, would remain largely under-utilised by the helicopter unit.

Thus, despite the fact that the air-field at Phalodi was sanctioned about 24 years ago, it is doubtful whether it will be commissioned as per the objectives for which it was proposed. As on date, its utility is negligible, given the constantly vacillating position of the IAF on its future use.

Case II: Delay in establishment of an Air Base

In June 1984, the CFA gave its approval for an Air Force station at Cholavaram near Chennai by inducting a squadron of combat aircraft from the authorised force level. The Base was meant to provide air defence cover to certain sensitive installations of national importance. As the State Government was reluctant to give clearance for an airfield at Cholavaram, Air HQ, without reverting to the CFA, decided (October 1987) to relocate the air base to Thanjavur (Tamil Nadu), where two runways of 1942 vintage existed. Thereafter, Ministry in December 1989 sanctioned the establishment of a Wing at Thanjavur. In spite of forming the Wing (November 1990) and spending Rs 35 lakh to improve the condition of the runway, the runways were not fit for operation of fighter aircraft. As a result, operations were restricted to a few transport aircraft and unscheduled civil flights. Till date, no fighter aircraft operation has taken place. By November 1993, IAF had changed its stance about the nature and priority of the base and once again, without obtaining the approval of the CFA, Air HQ downgraded and converted the Base into a Care and Maintenance Unit, thereby, restricting its role to care and maintenance of the few aircraft that visited the base.

In 1999, while keeping the project on priority, a development plan for the Wing was revived and a proposal was sent to Air HQ by HQ Southern Air Command (SAC). On the basis of a Board of Officers recommendations, HQ SAC proposed that minimum work services including the strengthening of runway and operational facilities like hangar, etc. be taken up on priority to make the existing airfield suitable for fighter aircraft operation during Phase I at an estimated cost of Rs 49.78 crore and other activities in subsequent phases. However, Air HQ truncated (June 2002) the recommended works services and approved creation of facilities worth Rs 25.69 crore omitting provision for hangar, storage accommodation and other operational facilities.

In March 2003, Ministry suggested that estimates for the whole project be prepared before seeking administrative approval and expenditure sanction. Later (April 2004), HQ Southern Air Command also advised that the development of the air-field be taken up as a Special Project[21] and not under the general Capital Works Plan (CWP). In March 2006, Ministry, while remarking on the inadequate planning, again advised Air HQ to complete the land acquisition process, Board Proceedings and issues related to Local Flying Area (LFA) before approaching the competent authority for development of infrastructure for the Wing. Ignoring this advice, Air HQ split the expenditure to be incurred into small works programmes as shown below.

Date	Entity	Amount	Remarks
December 2003	Air HQ	Rs 7.59 crore	Approved CWP-2003-04
February 2004	Air HQ	Rs 7.59 crore	--
June 2006	Air HQ	Rs 4.37 crore	--
March 2006 to May 2007	HQ SAC	Rs 10.04 crore	18 sanctions in total

Besides the recurring annual expenditure of Rs 4.47 crore on manpower, Air Force, till date, has invested Rs 42 crore on the acquisition of land and execution of civil works, yet the Air Base is far from fully operational as between January 2002 and June 2007, only 51 service aircraft/microlite/ helicopter visited the base. Thus, the intended air cover over sensitive installations remains elusive even after 25 years of government approval for activation of an air base.

The matter was referred to the Ministry in August 2009; their reply was awaited as of June 2010.

[21] In April 2004, it was decided to earmark separate funds from the total allocation of IAF for major projects under the code head 'Special Projects'. A new accounting head was to be opened for each project.

2.8 Financial irregularities in organising Military World Games 2007

Funding for the Military World Games 2007, organised by the Services Sports Control Board, violated financial rules and regulations. The approval of the competent financial authority (CFA) was taken for Rs 50 crore as against an estimate of Rs 138 crore. The financial arrangements have resulted in unspent balances lying outside of Government account, foregoing of revenue and diversion to non-public funds.

The Military World Games (MWG) is a multi-sport event for military sports people organised under the aegis of the International Military Sports Council (CISM). Indian Armed Forces are a member of CISM since 1999. In September 2003, the Services Sports Control Board (SSCB) submitted a proposal to host the 4th Edition of the MWG at Hyderabad and Visakhapatnam. The competent financial authority (CFA), i.e the Raksha Mantri (RM), accorded *in-principle* approval to the proposal in the same month at an estimated cost of Rs 20.32 crore. In November 2005, CISM awarded the MWG – 2007 to Indian Armed Forces for organising them in October 2007.

In June 2006, the Ministry of Defence (Ministry) sanctioned Rs 40 crore for the MWG[22], which was to be equally shared by the three Services out of their Sports Funds. In addition, the Ministry sanctioned, in March 2007, Rs 10 crore for making payment to the Andhra Pradesh (AP) Government[23]. Further, on the request of SSCB, Department of Defence Production directed Defence Public Sector Units to contribute for the games. Accordingly, DPSUs contributed Rs 19 crore to SSCB by October 2007. Audit noted the following financial irregularities in the management of project funds:

- Projects exceeding Rs 100 crore require the approval of the Cabinet. Although the SSCB (January 2006) required funds in excess of Rs 100 crore for the conduct of MWG, a proposal omitting work services was put

[22] For incurring expenditure on hospitality, reception, transport, IT infrastructure etc.
[23] For provision of infrastructure facilities, supply of electricity and water etc.

up to the Ministry for only Rs 40 crore. Interestingly, sanctions amounting to Rs 138 crore in total were issued for the MWG.

- It was decided to undertake the works services through the Capital Head allocations of the respective Services as per existing works procedures. The works services were sanctioned by according 37 piece-meal sanctions costing Rs 78 crore from 2006 onwards.

- An amount of Rs 4.76 crore received on account of charges realised from extra CISM contingents was diverted to non-public fund between September 2007 and June 2008.

- The money received from the sponsors totalling Rs 0.84 crore was spent by SSCB without the sanction of the Ministry.

- Additionally, unspent money to the tune of Rs 7.21 crore was not deposited into Government account. The principal amount and the interest thereon (Rs 28.14 lakh) is still held by SSCB in private banks without any authority.

- Entire amount of Rs 10 crore was paid as advance to AP Government in July 2007. However, no formal agreement was concluded with the AP Government for the Services to be provided by them. As a result, the AP Government did not furnish any contingent bills/ details bills to SSCB for the services provided by them. Audit also noticed that the electricity charges were estimated at the rate of Rs 16 per unit for 16 hours utilisation per day, against a rate of Rs 6.30 per unit which is the commercial rate applicable in Andhra Pradesh.

Thus, SSCB organised the 4th edition of MWG without obtaining the approval of the competent authority for the entire expenditure. Ministry failed to monitor the expenses incurred on MWG and the unspent amount has not yet been credited to Government account.

The matter was referred to the Ministry in September 2009; their reply was awaited as of June 2010.