CHAPTER VII: MINISTRY OF DEFENCE

Bharat Electronics Limited

7.1 Blocking of funds in Convergent Billing and Customer Relationship Management project

Accepting to execute a complex project, having fixed delivery schedule coupled with unlimited scope for expansion, without having expertise for the same, failure to enforce performance of the consortium partner and absence of back to back payment clause with vendors led to blocking of ₹ 144.85 crore for more than four years.

Mahanagar Telephone Nigam Limited (MTNL) floated a tender (April 2004) for implementation of Convergent Billing System and Customer Relationship Management (CRM) project. As per the tender conditions, teaming agreements with partners were required if the lead bidder was not an experienced integrator either in billing or in CRM. Accordingly, in order to bid for the project, Bharat Electronics Limited (the Company) entered (August 2004) into a Memorandum of Understanding (MoU) with various partners[1] including IBM which had expertise in System Integration (SI) for CRM projects.

Bid for project was submitted by the Company (August 2004) and, after a series of negotiations, MTNL placed (February 2006) a Purchase Order (PO) valuing ₹ 503.51crore (amended to ₹ 493.08 crore in February 2008) on the Company for executing the above project on turnkey basis to be completed within 12 months[2] from the date of PO. The scope of work included supply of hardware, software and system integration of different Lines of Business (LOBs) viz. IUC, GSM, CDMA, PSTN[3], Broadband, Leased Line etc to enable common billing for various services being offered to customers by MTNL at Delhi and Mumbai. Further, the contract recognized that in the likelihood of change in SRS[4], the changes were to be implemented by the Company without any additional financial implication and SRS was to be within the scope of the tender document.

Audit observed the following:

1 *Selection of System Integrator:*

- MoU on the basis of which the Company had made the bid for the project mentioned IBM as the supplier of Hardware for lead applications as well as supplier and integrator of CRM and ORG as networking integrator.

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[1] *IBM, ORG, Independent Technology Systems Limited (INTEC), Ushacomm India Private Limited, Peoplesoft India Private Limited and Xalted Information Systems Limited (SYSTEAM)*

[2] *Supplies were to be completed within seven months and installation and commissioning were be completed within 12 months from date of PO.*

[3] *IUC–Inter Operator Billing, GSM-Global Systems for Mobile Communication, CDMA-Code-Division Multiple Access, PSTN-Public Switched Telephone Network*

[4] *System Requirement Specifications*

- A Committee constituted by the Management (January 2006) for negotiating prices, terms and conditions with the vendors, was of the view (March 2006) that as good exposure and experience of handling complex integration were essential criteria for selection of a System Integrator (SI), the task can be carried out by IBM to the satisfaction of MTNL. However, IBM was not willing to take the responsibility and suggested that order for SI be placed on ORG.
- Company placed (27 March 2006) the order for SI on ORG and after three months (20 June 2006) entered into a Teaming Agreement with ORG wherein ORG was made responsible for overall SI but it could sub-contract the work to M/s. Satyam Computers.
- ORG sub-contracted the SI work to M/s. Satyam Computers Services Limited. Subsequently, the crisis in M/s Satyam computers resulted in delay in execution of work. Further, M/s ORG also went out of operation due to its internal financial crisis and the Bank Guarantee of ₹ 1.62 crore was encashed.

2 Acceptance of unfavorable payment clause:

- Though payments to the Company by MTNL were to be made in stages[♥] based on completion of work as prescribed in the contract, the purchase orders by the Company on the vendor provided for payments towards supply of hardware and software through Letter of Credit (LC) for full value of the supplies against dispatch documents.
- Supply of hardware and software (except for ORACLE RDBMS that was ordered in February 2008) was completed by March 2007. The cost incurred towards the project was approximately ₹ 293.12 crore (September, 2011) crore which included material supplies of ₹ 254.17 crore for which full payment was made by the Company. However, the work of installation and commissioning was only partially completed (January 2012) by ORG due to which the Company could not raise bill for supplies amounting to ₹ 144.85 crore despite making full payment to its vendors.

Management stated (October 2011) that the tender/SRS was generic in nature and new processes and business rules were revealed at the time of implementation and acceptance testing. The new services, network elements, call detail search system etc., were added, though within the scope of work. Further, at the time of bid, only limited services of MTNL were operational and envisaged in the scope of work. However, as a business enhancement, MTNL continuously launched many new services and expected the Company to deliver all the new services as a part of convergent billing.

The reply of the Management was not acceptable as:

- The Company should have taken adequate financial safeguards while accepting a project with open ended scope for expansion and a fixed delivery period

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[♥] ***Hardware- 60 per cent on supply, 20 per cent on satisfactory I&C and 20 per cent after one year of successful I&C; Software- 20 per cent on supply, 20 per cent on functional testing, 40 per cent after successful I&C and 20 per cent after one year of successful I&C; Services- 30 per cent after stage I SRS, 50 per cent after successful I&C, 10 per cent after stage II SRS and 10 per cent after implementation of changes as per stage II of SRS.***

- In the absence of expertise/experience in the field of SI, the Company should have protected its interest by fixing the responsibility on M/s. IBM for execution of the contract in full, and
- When contract was obtained on the basis of teaming agreements with various partners the Company should have also ensured incorporation of back to back payment clause corresponding with payment terms of MTNL

Meanwhile, it was ascertained from MTNL that as of January 2012 there has been no progress in the Project in the last seven months.

Thus, as a result of (a) acceptance to execute a turnkey project having fixed delivery schedule coupled with unlimited scope for expansion ; (b) failure to ensure performance of SI by IBM, the experienced consortium partner, inspite of its commitment, and (c) failure to incorporate back to back payment terms with its vendors, the Company failed to execute a prestigious and important project of MTNL even after five years of its scheduled completion date which resulted in blocking of ₹ 144.85 crore for more than four years (March 2012).

The matter was reported to the Ministry in October 2011; reply was awaited (May 2012).

Hindustan Aeronautics Limited

7.2 Excess payment of Performance Related Pay

Inclusion of interest income in the profit for calculation of Performance Related Pay in violation of Department of Public Enterprises (DPE) guidelines resulted in excess payment of ₹ 43.18 crore.

Department of Public Enterprises (DPE), Ministry of Heavy Industries and Public Enterprises approved (November 2008) Performance Related Pay (PRP) form January 2007 for Board level and below Board level executives and non-unionised supervisors in the Central Public Sector Enterprises (CPSE), which is to be directly linked to the profits of the CPSE for the year, incremental profit over the previous year, and performance of the executives. Each CPSE was to constitute a Remuneration Committee headed by an Independent Director to decide the annual bonus/variable pay pool and policy for its distribution across the executives, etc. within the prescribed limits. Further, while clarifying on the elements of Profit Before Tax (PBT) for computation of PRP, DPE recommended (November 2010) that profit of CPSEs is expected to come out from their specified objectives and core activities and that extraordinary items like valuation of stock, grant waived by Government, sale of land etc (list of items is not exhaustive) will not be included in calculation of PBT as far as PRP is concerned.

The Board of Directors of Hindustan Aeronautics Limited (HAL) approved (August 2010) a scheme of PRP for implementation from 2009-10, which specified adoption of a performance index with three elements of individual performance based on Performance Appraisal Report Score, divisional performance based on value addition, sales, cost reduction, outsourcing and standard man hour (SMH) output, and organisational performance based on MOU rating of the company as a whole by the Ministry of Defence (MoD) with distribution of weightages. PRP estimate of ₹ 105.52 crore for 2009-10 was notified (May 2011) by the Company and ₹ 101.27 crore was finally paid to the executives during May 2011.

We observed (September 2011) that the Company's PBT of ₹ 2,688.43 crore for 2009-10 which was considered for computation of PRP, included interest income of ₹ 1525.60 crore (56.75 *per cent* of PBT) earned on short term deposits of funds received mainly as advances from MoD for various projects entrusted to the Company. Ministry of Defence had provided to HAL an advance of ₹ 29,977.00 crore as on 31 March 2010 which rose to ₹ 35,147.00 crore as on 31 March 2011. Since the interest income was derived largely from extraordinary magnitude of advances received from MoD that is clearly disproportionate to the actual sales turnover of the Company averaging ₹ 12,286 crore between 2009-10 and 2010-11, it is illogical to reckon such income as one arising from the normal business and core activities of the Company. Therefore, due allowance should have been made for such extra ordinary income for the purpose of computation of PRP. It also needed to be reckoned that investment of surplus funds on advances received from defence customers is an incidental activity and not a core activity for the Company. If PBT had been arrived at only from income related to the core activities of the Company, PRP payable would have been ₹ 58.09 crore instead of ₹ 101.27 crore paid finally to the executives (May 2011).

Incidentally in the financial year 2007-08 and 2008-09, i.e. prior to this scheme the Company was implementing the Performance Improvement Pay (PIP) scheme which did not include the component of interest income.

In reply, Management stated (October 2011 and March 2012) that interest income qualified for PRP since it was from prudent working capital management of funds received through contractual terms of sale and therefore it was very much within the objective of the Company. The Ministry of Defence endorsed the Management's reply.

The Ministry's endorsement of the Company's PRP Scheme is unacceptable because uptill 2008-09 Company never reckoned interest on advances from MoD for computation of PBT for payment of PIP more so when the matter was clarified by DPE in November 2010 beyond any doubt and the Ministry (Department of Defence Production) ought to have clearly advised the Company to exclude "interest income" for purpose of working out the incentives.