

## Chapter IV: Procurement of Stores

### Audit objectives

*Whether the factories procured requisite stores efficiently and economically in tandem with the production requirements.*

### Source of audit criteria

- *Defence Procurement Manual;*
- *OFB's Material Management and Procurement Manual (2005); and*
- *General Financial Rules.*

### 4.1 General

After finalising the mutually agreed production targets, OFB communicates the same to the respective factories before commencement of each financial year for undertaking manufacturing activities. Thereafter, each factory formulates the production planning based on the target and initiates provisioning and procurement of input materials required for manufacturing the end products for that year.

Deficiencies in the procurement procedure and practices in ordnance factories had been commented upon in the PA Report No. 19 of 2007. Ministry in their ATN stated (December 2008) that OFB had taken various corrective actions to remove the deficiencies in procurement and practical difficulties in finalising store requirement, as detailed in **Annexure-I**.

However, we observed that systemic deficiencies in the areas of material planning and procurement, assessment of requirement of stores, tender formalities *etc.* still persisted, as discussed in the succeeding paragraphs.

**4.1.1** Table-6 indicates the factory-wise supply orders placed during 2008-12 and sample of the orders test checked by us.

**Table-6: Orders placed and orders examined**

*(Value ₹in crore)*

| Factory      | Orders placed |                | Orders examined |               |
|--------------|---------------|----------------|-----------------|---------------|
|              | Number        | Value          | Number          | Value         |
| OEFC         | 3572          | 591.05         | 299             | 255.94        |
| OCFS         | 1987          | 392.67         | 163             | 176.54        |
| OPF          | 3073          | 178.67         | 280             | 53.57         |
| OCFA         | 1731          | 207.26         | 136             | 120.31        |
| OEFH         | 1326          | 145.61         | 88              | 35.44         |
| <b>Total</b> | <b>11689</b>  | <b>1515.26</b> | <b>966</b>      | <b>641.80</b> |

*\*Note: Orders valuing less than one lakh each not selected in the sample.*

## 4.2 Over-provisioning of stores

As per Paragraphs 3.1.1 and 3.7.7 of Material Management and Procurement Manual (2005) (MMPM), factories are required to initiate provisioning action for input materials on the basis of annual production targets of the end-products for the ensuing year as well as for additional 25 *per cent* quantity for the first quarter of the next year. The net requirement of the stores is to be arrived at after considering the existing stock, dues in and work-in-progress.

We examined 810 cases of provisioning of stores with reference to the estimates relating to 2008-11 and observed that in 679 cases, in deviation from the laid down procurement norms, Material Control Offices (MCOs) of five factories assessed the net requirement of stores for a particular year after considering the past year's requirement and 'miscellaneous/extra requirement' in addition to the current year's requirement. This deficiency in assessment of requirement by addition of miscellaneous/extra requirement was also vetted and cleared by the Accounts Office of the factories. The Tender Purchase Committees (TPCs) also finalised their recommendations without proper check and verification of this faulty assessment of requirement. This led to over-provisioning of stores worth ₹165.54 crore during 2008-11, as detailed in Table-7.

**Table-7: Details of over-provisioning of stores**

|                 |              |  | (₹ in crore)                     |
|-----------------|--------------|--|----------------------------------|
| Name of factory | No. of cases | Reasons for over-provisioning  | Total value of over-provisioning |
| OPF             | 4            | Inclusion of past year's requirement.  | 1.72                             |
|                 | 1            | Excess procurement over and above the requirement                                    | 0.51                             |
| OEFC            | 13           | Inclusion of past year's requirement.  | 75.34                            |
|                 | 478          | Inclusion of 2 <i>per cent</i> miscellaneous requirement                             | 7.31                             |
| OCFS            | 40           | Inclusion of 4/10 <i>per cent</i> miscellaneous requirement                          | 60.86                            |
|                 | 3            | Inclusion of past year's requirement.  | 8.10                             |
| OCFA            | 31           | Inclusion of 1 <i>per cent</i> miscellaneous requirement                             | 0.78                             |
|                 | 6            | Inclusion of past year's requirement.  | 9.57                             |
| OEFH            | 103          | Inclusion of 0.75 to 2 <i>per cent</i> miscellaneous requirement as UAR <sup>5</sup> | 1.35                             |
| <b>Total</b>    | <b>679</b>   |  | <b>165.54</b>                    |

The Ministry's response and our comments are given in Table-8.

<sup>5</sup> Unavoidable rejection

**Table-8: Ministry's response and Audit comments**

| Ministry's response   | Audit comments  |
|---|---|
| <ul style="list-style-type: none"> <li>• Inclusion of miscellaneous requirement for smooth functioning of shops was in practice since long and against the provision of unavoidable rejection (UAR) in the estimate, testing quantity, etc. However, the practice had been discontinued since 2010-11. <i>(OEFC and OCFS)</i></li> <li>• Past year's requirement was included but the dues from various supply orders and materials already received against the orders placed for past year's requirement was subtracted from the quantity to arrive at the actual requirement. Hence, there was no over-provisioning. <i>(OEFC)</i>.</li> </ul> | <ul style="list-style-type: none"> <li>• Inclusion of miscellaneous requirement to calculate net requirement for a particular provisioning period was contrary to the MMPM (2005). Further, the Ministry's claim that the practice had been discontinued since 2010-11 was factually incorrect as OCFS and OEFC followed the same practice even during 2010-11. Moreover, the material estimate itself included UAR percentage. Hence, assessment of excess requirement again for UAR by OEFC and OCFS lacked justification.</li> <li>• Inclusion of past year's requirement to calculate net requirement for a particular provisioning period was also contrary to the MMPM (2005).</li> </ul> |

### 4.3 Non-observance of procedures for opening of tenders

#### 4.3.1 Non-preparation of Spot Comparative Statement

Paragraph 6.14 of MMPM stipulates the necessity to prepare an abstract of the quotations received, viz. 'Spot Comparative Statement' (SCS) in the prescribed form, duly signed by the officers who open the tenders, after opening of tenders.

We observed that in violation of MMPM, OPF, OEFC and OCFS did not prepare SCS in respect of 658 supply orders test checked by us during 2008-11. This indicated lack of transparency in evaluation of tenders and short-listing of suppliers.

The Ministry/OFB stated (May/April 2012) that SCS was prepared in OPF and OCFS after introduction of on-line system but the same was not in force in OEFC which would be taken care of by the system itself with introduction of e-tendering. However, the reply did not explain as to why SCS was not prepared during 2008-11.

#### 4.3.2 Lack of transparency in the attendance of representatives of firms

Paragraph 6.12 of MMPM requires that one Purchase Officer and another Officer nominated by General Manager should open tenders on the specified date and time in the presence of only authorised representatives of the tendering firms. CVC guidelines (7 January 2003) and Paragraph 4.7(h) of Defence Procurement Manual (DPM), 2005 also stipulate that one agent cannot represent two suppliers or quote on their behalf in a particular tender enquiry and that if such quotes are received, they should be rejected.

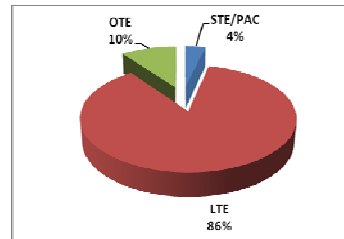
We, however, observed that OCFS and OEFC did not maintain the details of the names of the firms nor were the authority letters obtained from the participating firms. Further, we observed that same persons were found to have represented two or more firms against the same TE on various occasions in OEFC in contravention of CVC guidelines and DPM.

The Ministry claimed that OCFS maintained records of attendance of the firm’s representatives and this aspect would be taken care of by OEFC after introduction of e-tendering. The Ministry added that OEFC could not have questioned the appointment of representatives as it was the firm’s prerogative to appoint any person to represent it in tender opening. The reply is not factually correct as relevant register of OCFS examined by us had no mention about the details of the attendance of the firms’ representatives and their signature. Further, the Ministry’s contention about the acceptance of appointment of same representatives by two or more firms against the same TE is contrary to the direction of CVC.

#### 4.4 Procurement through Limited and Single Tender Enquiry instead of Open Tender Enquiry

As per Paragraph 4.6.1 of MMPM, 80 per cent of annual ordering quantity is to be procured through limited tender enquiry (LTE) from established sources and 20 per cent quantity through open tender enquiry (OTE) for source development.

We examined all 11689 supply orders placed by five factories during 2008-12 and observed that contrary to the MMPM, only 4 to 10 per cent of the orders were executed through OTE except OCFS which had attained 20 per cent,



while 88 to 91 per cent orders were placed against LTE by OPF, OEFC and OCFA, as tabulated below:

**Table-9: Details of tender enquiries**

(In number)

| Factory      | Supply Orders | Procurement through |                       |                   |
|--------------|---------------|---------------------|-----------------------|-------------------|
|              |               | STE/PAC             | LTE                   | OTE               |
| OPF          | 3073          | 60 (1.95%)          | 2754 (89.62%)         | 259 (8.43%)       |
| OEFC         | 3572          | 96 (2.69%)          | 3159 (88.44%)         | 317 (8.87%)       |
| OCFS         | 1987          | 70 (3.52%)          | 1527 (76.85%)         | 390 (19.63%)      |
| OEFH         | 1326          | 116 (8.75%)         | 1074 (81.00%)         | 136 (10.25%)      |
| OCFA         | 1731          | 82 (4.74%)          | 1582 (91.39%)         | 67 (3.87%)        |
| <b>Total</b> | <b>11689</b>  | <b>424 (3.63%)</b>  | <b>10096 (86.37%)</b> | <b>1169 (10%)</b> |

A test check of supply orders placed during 2008-11 showed that the factories predominantly resorted to procurement through LTE, incurring extra

expenditure of ₹12.31 crore for procurement of 14 items involving 40 supply orders due to rate difference as compared to OTE. Factory-wise responses of the OFB / Ministry are given in Table-10.

**Table -10: Factory-wise Ministry/OFB's response**

| Factory | Ministry/OFB's response   |
|---------|---|
| OPF     | Quality cannot be compromised for critical materials by going for tender enquiries from unknown vendors through OTE.  |
| OEFC    | 20 per cent OTE for source development were not floated for meagre value stores as OTE is costly and time consuming. More OTEs are being floated for 50 per cent of required quantity as per new Procurement Manual 2010. |
| OCFS    | For indirect items having lower quantum and value, mostly LTEs were issued. Receiving lower rate in OTE compared to LTE was not an established fact.  |
| OEFH    | For 'A' category items, 80 per cent LTE and 20 per cent OTE were resorted to.   |
| OCFA    | Guidelines as per OFB's MMPM 2005 were followed.  |

Moreover, if there were constraints as stated in tendering by OTE, this should have been looked into. The fact remains that 88 to 91 per cent procurement by OPF, OEFC and OCFA was through LTE which was in violation of 80:20 ratio prescribed in the MMPM.

#### 4.5 Long lead time for placement of orders

Annexure-47 of MMPM provides for 15 weeks (105 days) for LTE and 19 weeks (133 days) for OTE to complete the procurement process of the cases within the power of General Manager of Factory, starting from generation of Store Holder Inability Sheet (SHIS)<sup>6</sup> and up to placement of the orders on the selected firms.

We observed that 35 per cent of total supply orders were placed during 2008-12 beyond the lead time stipulated in MMPM, as depicted in Table-11.

**Table-11: Details of lead time taken for placement of supply orders**

(Value ₹ in crore)

| Factory      | Total Supply Order |                | Orders placed with delay |               | Time taken (in days) |
|--------------|--------------------|----------------|--------------------------|---------------|----------------------|
|              | Number             | Value          | Number                   | Value         |                      |
| OPF          | 3073               | 178.67         | 1107                     | 66.41         | 134 to 1441          |
| OEFC         | 3572               | 591.05         | 1230                     | 130.60        | 134 to 890           |
| OCFS         | 1987               | 392.67         | 761                      | 131.01        | 135 to 1428          |
| OCFA         | 1731               | 207.26         | 536                      | 52.32         | 134 to 1049          |
| OEFH         | 1326               | 145.61         | 483                      | 50.29         | 134 to 1053          |
| <b>TOTAL</b> | <b>11689</b>       | <b>1515.26</b> | <b>4117</b>              | <b>430.63</b> |                      |

This led to non-positioning of input materials as per the production plan which ultimately resulted in delayed/shortfall in production and issue of items to the Services as discussed in subsequent Chapter-V.

<sup>6</sup> SHIS indicates total requirement, present stock and dues, net requirement, etc.

The Ministry attributed the delays to the time taken for submission of cases beyond ₹10 lakh to OEF HQ for concurrence of the nominated Member/Finance at Kanpur in respect of OEFH, non-availability of TPC members, holding of TEC and TPC meeting separately, negotiation of price, or verification of capacity of the new vendors. This reply is not relevant since the internal lead time has been fixed taking into account all the complexities of the procurement process. Hence, the slippages should have been avoided through proper planning and coordination amongst different wings.

#### **4.6 Procurement of stores at higher rates beyond eight per cent of LPR**

In line with the Ministry's advice (December 2006) for ensuring reasonableness of price, OFB directed (April 2007) all General Managers to keep the prices in control and to restrict increase in prices, if any, within eight *per cent* of the Last Purchase Rate (LPR). General Managers were also directed to forward monthly report to Member/Operating Division on cases where increase of price is beyond eight *per cent* with the detailed justification with reference to market indices, base metal price increase *etc.*

We examined supply orders placed during 2008-11 and observed that 107 supply orders valuing ₹94.33 crore were placed by the five factories at rates higher than the LPR by 21 to 146 *per cent*. Though these cases involved increase in expenditure by ₹22 crore beyond the authorised limit, none of the General Managers reported them with detailed justification to the Addl. DGOF, OEF HQ Kanpur. OFB also did not oversee the placement of orders by the General Managers at the rates more than eight *per cent* of the LPR to ensure price reasonableness, as advised by the Ministry.

While admitting the fact, the Ministry stated that the price indices of major textile raw materials had gone up by 30 to 50 *per cent* and thus this value of eight *per cent* needed review at the apex level and preferably be substituted with suitable price variation formula involving standard indices. The contention is not acceptable because hike in price beyond eight *per cent* should have been explained and reported by the General Managers to the Addl. DGOF. If the Ministry had felt the necessity to enhance the threshold limit of eight *per cent*, it should have appropriately acted upon by giving suitable justification.

#### **4.7 Formation of cartel**

Mention had been made of formation of cartels in Paragraph 4.2.2 of Report No. 19 of 2007 of Comptroller and Auditor General of India.

Ministry in their ATN of December 2008 had stated that after introduction of anti-cartel clauses in the tenders with effect from July 2007, instances of cartel formation came down drastically. In order to avoid cartel formation by the suppliers of input materials, OFB directed (July 2007) General Managers of all factories to incorporate the following conditions in tender enquiries (TEs):

- all the firms should desist from forming cartel as it is an offence under the Competition Act 2002;
- factories reserve the right to delete the established firms who quote in cartel, from list of approved sources or to debar them from competing for a period to be decided by factories;
- in case of submission of equal rates in cartel by the approved firms, factories reserve the right to place order on any one or more firms with exclusion of the rest. The selection would, however, be based on a pre-determined ranking of firms, decided through a Vendor Rating mechanism in line with OFB's Standard Operating Procedure (SOP). SOP prescribes that ranking of the vendors should be based on Quality, Delivery, Price and Service parameters with weightage factor of 60, 25, 10 and 5 respectively against the orders already placed on the vendors; and
- factories reserve the right to place order on two or three firms where the tendered quantity will be distributed in the ratio 60:40 or 50:30:20 among Rank-1 (R1), Rank-2 (R2) or R1, R2 and Rank-3 firms respectively.

We observed that no vendor rating mechanism had been carried out. We examined firms' quotations against 85 TEs as well as Minutes of Tender Purchase Committee (TPC) meetings for 2008-12 and noticed that in 33 cases, two or more firms had quoted equal rates. However, despite this evidence of cartel formation, the OEFG did not reject the cartelised offers, as required under the OFB's direction of July 2007. Instead, in violation of provision of MMPM and SOP, OEFG placed 102 supply orders valuing ₹33.91 crore on various firms against 33 TEs without carrying out the requisite vendor rating, as detailed below:

- OPF placed 26 orders valuing ₹6.57 crore against 10 TEs on various firms which had quoted identical rates, by equal distribution of the tendered quantities.
- In OCFA, OCFS and OEFH, 40 orders valuing ₹14.03 crore were either equally distributed or distributed in the ratio of 60:40 or 50:30:20 amongst the firms which had quoted same rates against 11 TEs.

- In OEFC, 36 orders valuing ₹13.31 crore were placed against 12 TEs on various firms where two or more firms quoted L-1, L-2 and L-3 rates. Hence, orders were distributed amongst the firms in the ratio of 50:30:20 or 60:40.

OFB stated (April 2012) that vendor rating system had been introduced and the same was being followed. The contention is not acceptable because since the introduction of vendor rating system in July 2007, only OCFA had followed the system after expiry of three years *i.e.* from July 2010, while other four factories under OEFG did not act upon the OFB's directives of July 2007. Further, the reply is silent as to why other four factories failed to act upon the OFB's directives (July 2007) for item-wise vendor rating mechanism to effectively counter the cartel formation.

In 102 cases pointed out by us where cartelisation was found, neither the factories concerned made any enquiry nor did the OFB call for explanation from the factories concerned. As a result, it could not be ensured that the best economic and competitive offers were obtained.

#### **4.8 Audit conclusion**

In spite of issue of guidelines by OFB/Ministry from time to time to streamline the procurement process, deficiencies like over-provisioning of stores, lack of transparency in procurement of stores, procurement through LTE at higher rates instead of OTE as well as procurement at higher rates beyond eight *per cent* of LPR, delayed placement of orders, non-adherence to vendor rating mechanism continue to exist. The OFB had also not succeeded in breaking the cartel among the vendors despite earlier audit comments and the Ministry's ATN.

#### **Recommendation 3**

*OFB may ensure that the factories adhere to the prescribed policy/guidelines in assessment of net requirement of stores for reliable and accurate provisioning to avoid excess procurement.*

#### **Recommendation 4**

*The e-procurement system should be implemented effectively in all the factories and all factories should maintain shareable database.*

#### **Recommendation 5**

*OFB may ensure that the procurement agencies strictly adhere to the OFB's guidelines of July 2007 to prevent cartelisation.*