

## CHAPTER II: MINISTRY OF CIVIL AVIATION

### Airports Authority of India

#### **2.1 Allotment of land for setting up and operations of flying clubs**

##### **2.1.1 Introduction**

Airports Authority of India (AAI) was formed by merger of International Airports Authority of India and National Airports Authority and came into existence on 1 April 1995 with the enactment of the Airports Authority of India Act, 1994. Section 11 of the Act envisaged that AAI in the discharge of its functions under the Act shall act on business principles. Till formation of AAI, Director General of Civil Aviation (DGCA) allotted land and hangar spaces to various flying schools/clubs/academies to impart training and other aviation related activities. This work was taken over by AAI from 1995.

Till 2007, AAI did not have a defined policy for levying charges on flying schools/ flying clubs. In February 2007, AAI decided to classify flying clubs into two categories which are as follows:

**Category I:** - Flying clubs/flying training organization registered as educational societies and operating on 'no profit no loss' basis to be charged nominal rates i.e. @ 10 per cent of the normal rates.

**Category II:** - All other flying clubs/institutions to be charged at normal AAI rates for various services.

There were 32 flying clubs/schools situated at various airports, under the control of AAI, in India (March 2014). The scope of audit was limited to the review of records at the AAI Corporate Office and examination of records at five regional headquarters Chennai (Southern), Mumbai (Western), Delhi (Northern), Kolkata (Eastern and North Eastern) and Hyderabad for a period of three years ended 31 March 2013; however, the data given in the para has been updated upto 31 March 2014.

Audit was carried out with the objective to assess efficiency of AAI in framing and reviewing policy for fixation of charges to be levied on flying clubs and its effective implementation.

##### **2.1.2 Audit Findings**

###### **2.1.2.1 Failure to allot land for setting-up of flying clubs:**

Board of Directors (Board) of AAI accorded (21 February 2007) 'in principle' approval for allotment of land for setting up of Flying Schools/ Aircraft Maintenance Workshops at different airports by calling Expression of Interest (EOI) subject to availability of land. In

March 2007, AAI invited 'Expression of Interest' for setting up of flying schools/aircraft maintenance workshops at 31 airports after confirmation from the Regional Offices regarding availability of requisite area of land. A committee was constituted which invited tenders in phases for setting up of flying schools. The AAI Board accorded (November 2007) its approval to allot minimum one acre and at the most 2.5 acres of land subject to availability at each of the airports. Some of the important bidding parameters were as follows:

- (i) Not more than one site will be allotted to a successful bidder even if the bidder becomes successful at more than one airport.
- (ii) In case either or both of the sites are not available at a particular airport, due to any reason whatsoever, the successful bidder shall have no right for any claim.
- (iii) The lease of land shall be for a period of 5 years extendable by another 5 years on mutually agreed terms and conditions.

Audit observed lapses in allotment of land for setting up of flying clubs in the following cases:

**(a) Ludhiana Airport:** The successful bidder M/s. Bird Consultancy Services Private Limited (BCS) quoted a minimum guaranteed royalty of ₹ 23.25 crore for five years apart from the required license fee. The bidder was offered (November 2007) a choice between two sites, measuring 1 acre each. Based on their requirement, M/s BCS requested (November 2007) AAI for an allotment of 2.5 acres of land. AAI, therefore, offered (December 2007) two sites one of 2.5 acres (approx) and the other of 1 acre, with the condition that M/s BCS would relocate the flying club at their own cost if it became necessary to do so for the envisaged development of Ludhiana Airport. In response M/s. BCS requested (January 2008) AAI to make an alternate arrangement for land allotment. AAI, however, without considering the same, allotted (July 2009) land measuring approx. 2.5 acres to M/s BCS. M/s BCS, however, turned down the conditional offer and final award of tender did not take place. As of August, 2014 the envisaged development of Ludhiana airport has not materialized. Thus, allotment of land to the successful bidder on a condition not acceptable to the bidder resulted in loss of opportunity to AAI to earn revenue in the form of minimum guaranteed royalty amounting to ₹ 23.25 crore apart from the license fee.

**(b) Nadirgul Airport:** Due to delay on the part of AAI to identify suitable land, the successful bidder (July 2007) M/s Guru Nanak Educational Trust could be allotted land only in July 2009. The party, however, declined to accept the allotment due to undue delay. Thus non identification of the site before calling bids and inordinate delay in allotment of land to successful bidder resulted in revenue loss of ₹ 2.44 crore to AAI in the form of minimum guaranteed royalty apart from the license fee.

The Management confirmed the facts (December 2013) relating to non-allotment of land at Ludhiana and Nadirgul airports and stated that policy on flying schools was under formulation which would take care of all these issues in future. The above said policy is yet to be formulated (August 2014).

**(c) Behala Airport:** Due to delay in identification of the site by AAI, the successful bidder M/s Trans Bharat Aviation (P) Limited (TBA) was allotted land in June 2009 i.e. after six months from the date of selection (December 2008). The no objection certificate (NOC) for construction of hangar was issued by AAI only in July 2010 by which time the approval obtained by TBA from DGCA for setting up of flying institute was on the verge of expiry (August 2010). As DGCA denied further extension to TBA, the flying institute could not be set up. This resulted in revenue loss of ₹ 4.21 crore to AAI in the form of minimum guaranteed royalty quoted by TBA apart from the license fee.

Though the Management confirmed the facts (November 2013), no comments were offered for delay in issuance of NOC.

**(d) Khajuraho Airport:** M/s. Falcon Aviation Academy (FAA) was given formal allotment letter in November 2009 i.e. after a lapse of almost one year after the date of selection (December 2008). M/s. FAA expressed its inability to complete the formalities till 21 January 2010. The AAI, however, decided to forfeit the EMD of the party and to call for fresh tenders. So far (March 2014), the land has not been allotted to any flying club. Thus, due to an inordinate delay in issuing formal allotment letter, AAI lost an opportunity to earn revenue of ₹ 1.65 crore for five years in the form of minimum guaranteed royalty quoted by FAA apart from the license fee.

The Management confirmed the facts (November 2013); however, no comments were offered on delay in identification of the site by AAI.

It emerges from the above mentioned cases that AAI did not have an efficient system in place for identification of sites before inviting bids for setting up flying schools at various airports. There were unreasonable delays in allotment of land to successful bidders leading to loss of revenue for AAI both in the form of royalty quoted by bidders and the license fee which could have been earned from these flying schools.

#### **2.1.2.2 Absence of monitoring credentials of flying clubs**

Pursuant to AAI's decision of February 2007 regarding charges to be recovered from flying clubs, a list of 28 flying clubs falling under category I and 13 under category II was circulated to all airports in April 2007. All flying clubs covered under category I were required to produce a current valid certificate in support of their credentials for availing the benefits of levy of nominal rates, failing which, following course of action was to be taken:

- 90 days notice to be issued to such flying clubs to stop operations and surrender land and hangar space occupied by them after clearing outstanding dues.
- License fee be charged from such flying club on normal rates plus 13 *per cent* of the gross turnover (GTO) for all activities carried out by them at the respective airport.
- In case of non compliance with the above, occupation of land and hangar space by the flying clubs was to be treated as unauthorized and necessary action was to be taken for eviction.

Audit observed that AAI initiated, only in January 2010, the process of verification of the credentials for eligibility of category I, though the categorization of the clubs was decided in February 2007. Thus, due to delay on the part of AAI in executing its decisions, the following four Flying Clubs were able to evade normal rates for AAI services which resulted in revenue loss to AAI:

**(a) Delhi Flying Club (DFC):** DFC was established in 1957 at Safdarjung Airport and placed (February 2007) in category I. Last agreement with DFC was entered in 1982 for a period of five years, i.e. up to 31 March 1987. Thereafter, the agreement was not renewed. DFC was not carrying out any flying training/flying related activity since January 2002. Further, in compliance of instructions issued by AAI in January 2010 for verification of the credentials for eligibility of category I, DFC also failed to furnish any credentials in support of their categorization under category I. AAI was also aware that since October 2007 DFC was letting out allotted land/buildings for commercial purposes such as, operating IGNOU study centre, conducting interviews for air hostesses and religious/marriage functions etc.

Audit scrutiny revealed that no bills were raised by AAI to charge applicable license fee plus 13 *per cent* of Gross Turn Over (penal rates) and neither any eviction proceedings were initiated against DFC which had not paid even its outstanding dues as per category I rates and an amount of ₹ 7.54 crore was recoverable as of March 2014. Had AAI raised bills as per normal rates, the outstanding amount would have increased to ₹ 19.26 crore (February 2007 to March 2014).

**(b) Bombay Flying Club (BFC):** BFC established at Juhu Airport, Mumbai in 1931 and was placed in category I by AAI. BFC which was a company under the Companies Act, 1913 till March 2011, was carrying out commercial activities other than flying training and was also not operating on 'no profit no loss' basis. In March 2011, BFC was converted to a society registered under Societies Act, 1860. However, AAI took no action to verify and ensure whether BFC was eligible for privileges under category I and whether the Club was operating on 'no profit no loss' basis. Moreover, from 2008-09 onwards BFC had not paid its outstanding dues even as per category I rates and an amount of ₹ 3.60 crore was recoverable as of March 2014. BFC filed Writ Petition No. 858 of 2012 before High Court, Bombay, against levy of charges by AAI. The Court in its interim order directed BFC to pay ₹ 2.50 lakh per month with effect from 01-4-2012.

AAI informed (February 2014) Audit that in compliance with court order, BFC paid three installments totaling ₹ 7.50 lakh and thereafter, in compliance with MoCA instructions (09 October 2012), AAI decided (November 2012) to keep the order of recovery of outstanding dues from Category-I Flying Club in abeyance till further orders. Audit is of view that had AAI raised bills as per normal rates, the outstanding amount would have increased to ₹ 36.86 crore (February 2007 to March 2014).

**(c) Madhya Pradesh flying club (MPFC), Bhopal:** MPFC was established at Bhopal Airport in 1986 and was placed in category I by AAI. MPFC utilized the premises allotted to them for commercial purposes such as parking/maintenance of aircraft of private agencies. Audit observed that AAI neither raised bills at penal rates nor did they initiate eviction proceedings against MPFC. Resultantly AAI failed to raise bills

amounting to ₹ 0.81 crore (from 2008-09 to 2013-14) on account of differential between normal and nominal rates.

**(d) Madhya Pradesh flying club (MPFC), Indore:** MPFC was established at Indore Airport in 1961 and was placed in category I by AAI. Audit observed that the club, which was registered as a company under the Companies Act 1913, was carrying out commercial activities other than flight training and hence was not eligible to be placed in category I. However, neither bills at penal rates were raised by AAI nor eviction proceedings initiated against MPFC, Indore. MPFC, Indore had not paid even its outstanding dues as per category I rates and an amount of ₹ 0.80 crore was recoverable from it as of March 2014. Had AAI raised the bills as per normal rates outstanding amount would have increased to ₹ 9.10 crore (from 2008-09 to 2013-14).

### 2.1.2.3 Non realization of dues.

#### (a) Due to absence of any agreement with flying clubs

AAI issued a circular (May 2007) to all its Airport Directors to review and renew 'land license' agreements with flying clubs and clarified that any occupation beyond the valid agreement period would amount to unauthorized occupation, which was to be dealt with as per penal provisions. It was incumbent upon AAI to enter into fresh agreements with the parties occupying land/space at various AAI airports, but no such efforts were made by AAI. In the absence of agreements, realization of dues outstanding against such parties could not be enforced. Airport Directors/Regional Offices had not taken action to renew the land license agreements. Details of outstanding dues from flying clubs at various AAI airports, not realized in absence of a legally binding agreement were as follows:

Airport	Name of the Party	Date of Land Allotment	Last Agreement entered	Amount due as on March 2014
Safdarjung	Delhi Flying Club	April 1957	1982 for 5 years	₹ 7.54 crore
Begumpet	M/s Andhra Pradesh Aviation Academy	August 1969	1982 for 5 years	₹ 2.24 crore
Amritsar	Amritsar Aviation Club	1962	Up to 1994	₹ 0.37 crore
Jaipur	Rajasthan Flying Club	April 1966	1966	₹ 5.77 crore
Guwahati	Assam Flying Club	May 1958	No agreement till date	₹ 1.11 crore
Kanpur	U. P Flying Training Instt. (upto April 2012, as party surrendered the land without clearing dues).	1952	No records available	₹ 9.57 crore

Ministry of Civil Aviation (MoCA) advised (09 October 2012) AAI to place the issue of recovery of dues from category-I flying clubs before AAI Board and keep the order of recovery of charges in terms of AAI Board resolution of 2007 in abeyance, till finalization of the policy of the Ministry regarding prescribing the eligibility criteria for flying clubs for availing facility of nominal rates for various charges payable to AAI. Accordingly, AAI instructed (November 2012) all airports to keep recoveries from

category I flying clubs in abeyance till further orders. Audit scrutiny revealed that as of August 2014, the said policy has not been finalized by MoCA.

Audit also observed that due to lapses on the part of AAI in renewal of land license agreements, some flying clubs were in occupation of land in excess of allotment as follows:

Airport	Name of the Party	Area (in sq. mtrs.)		
		Allotted	Actually occupied	Unauthorized occupation
Safdarjung	Delhi Flying Club	3124	6168.33	3044.33
Begumpet	M/s Andhra Pradesh Aviation Academy	454.42	5593.32	5138.90

**(b) Salem Airport**

(i) M/s International Aviation Academy Private Limited (IAAP) was allotted land in July 2009 at Salem airport and paid the license fee for the first and second year and royalty for the first year in advance. However, due to delay in commencement of operations in view of pending approval from DGCA, it could not clear its dues thereafter. IAAP also did not honour the interim orders (December 2011) of Madras High Court to deposit an amount of ₹ 50 lakh within a period of six weeks. IAAP started flying activities from 2012. Audit observed that neither was IAAP evicted nor the dues realized and an amount of ₹ 11.71 crore was outstanding (March 2014) against the club.

(ii) M/s. Kohinoor Educational Services Private Limited (KESP) was allotted land at Salem airport in March 2009 and started flying activities from June 2010. KESP, did not meet its contractual obligations in terms of payments. However, no action to realize dues from KESP was taken nor any eviction orders issued by AAI. An amount of ₹ 11.76 crore was outstanding (March 2014) against KESP.

The Management while confirming the above facts (November 2013 & March 2014) stated that eviction proceedings had been started against both clubs.

The fact, however, remains that both clubs continue to occupy AAI land without clearing their dues.

**(c) Kolkata Airport**

M/s Multiple Manpower Development Private Limited (MMDPL), Kolkata was allotted hangar space (510.20 sqm.), built up space (42.73 sqm) and paved land (2700 sqm) for a period of one year from 5 December 2006 for flying training activities at Behala civil aerodrome. The above contract was extended up to 31 December 2008 on the same terms and conditions, except royalty, which was enhanced from 12 to 13 *per cent* of the total revenue proceeds.

Notice Inviting Tender (NIT) was called for by AAI (November 2008) for establishing flying schools on AAI airports. As per the NIT, “those private flying clubs on AAI land whose license had expired and those whose license is still valid may be allowed to take part in the tender and in the event of their not being successful in the tender they would

have to vacate the existing premises and hand over the same to AAI". MMDPL did not participate in the bid but requested (June 2009) that their contract may be extended for a period of 5 years. MMDPL also agreed to pay royalty equivalent to that quoted by the successful bidder and license fee for the space under their occupation. Accordingly, AAI allotted (January 2009) the area to MMDPL for a period of five years. MMDPL, however, disputed the calculation of license fee at a higher rate and refused to enter into an agreement and continued to occupy the space unauthorisedly without making any payment.

AAI initiated (February 2011) eviction proceedings and passed an eviction order (July 2011) directing MMDPL to pay arrears for the period December 2006 to December 2010 amounting to ₹ 2.46 crore. Thereafter, MMDPL approached the Airport Appellate Tribunal which dismissed the appeal (February 2013). MMDPL finally approached (July 2013) AAI for execution of fresh agreement and waiver of arrears of license fee and royalty from 01.01.2009. Later on, AAI initiated legal action against MMDPL in June 2014. An amount of ₹ 8.43 crore was outstanding (May 2014) against MMDPL.

***(d) Safdarjung Airport, New Delhi***

DGCA had allotted land measuring 825.25 sqm to M/s Delhi Gliding Club at Safdarjung Airport, New Delhi. However, records relating to allotment were not available with AAI and no agreement in this regards was found on record. Flying activities were closed at Safdarjung airport since January 2002.

Audit observed that though Delhi Gliding Club had closed glider flying activities more than 11 years ago, AAI did not take action to realize outstanding dues amounting to ₹ 2.48 crore (March 2014) or to get the premises vacated by the club.

***2.1.2.4 Aero Club of India***

Aero Club of India (ACI), an apex body of over 22 flying/ gliding clubs and other aero sports organizations was allotted (1984) land measuring 1617.10 sqm at Safdarjung Airport for a period of 30 years with effect from 19 September 1983 at a nominal license fee of ₹ 1/- per annum. As per terms of agreement (December 1984) the land license fee was subject to revision. Though AAI raised the bills at revised rates (2007) retrospectively from 1986 onwards, it could not realize dues and ₹ 2.77 crore were outstanding against ACI as on 31 March 2014. However, AAI did not take action either to realize dues or to evict ACI from the premises.

As lease of ACI expired on 18 September 2013, ACI requested (July 2013) MoCA to extend the lease for another 99 years on the existing terms and conditions. Though such extension was not in line with the policy of AAI, MoCA proposed to approve extension of lease period by another 30 years from 19 September 2013 at a license fee of ₹ 1/- per annum and forwarded the case to AAI. Board of AAI in 157<sup>th</sup> meeting (December 2013) accorded approval to the proposal of MoCA, considering it as a special case and forwarded (February 2014) the case to MoCA for obtaining approval of the competent authority. ACI was still in unauthorized occupation of the space without clearing the dues (August 2014).

## Conclusion

There was inordinate delay in formulation of a policy regarding levy of airport charges and allotment of land to flying clubs and the attempt of framing policy in 2007, did not bear any result even till August 2014. In the absence of timely action and mechanism to verify the eligibility under Category I or II, flying clubs which were involved in other commercial activities and also otherwise not entitled to avail the benefits of concessional rates continued to enjoy the same. Further, in absence of any agreement with the parties, most of the flying clubs raised disputes regarding rates and did not clear their dues. Moreover, AAI suffered losses due to delay in identification of sites and issuance of required clearances.

The matter was reported to the Ministry in January 2014; their reply was awaited (March 2015).

### ***2.2 Disregard of provisions of Shareholders Agreement by MoCA and AAI resulted in additional burden on the travelling public in the form of Development Fee in IGI Airport, Delhi***

**MoCA and AAI failed to bring to the notice of AERA the provisions of Shareholders Agreement which mandated affirmative vote of AAI till such time AAI held 10 per cent equity shares in DIAL, in respect of special resolution under the Companies Act, 1956 and Reserved Board Matters. This led to levy of Development Fee by DIAL, resulting in additional burden on the travelling public of ₹ 3415.35 crore.**

The Government of India (GoI), in its Order dated 9 February 2009, granted approval to Delhi International Airport Private Limited (DIAL)<sup>▼</sup> for levy of Development Fee (DF) at the rate of ₹ 200 per embarking domestic passenger and ₹ 1300 per embarking international passenger, inclusive of all applicable taxes under section 22 A of the AAI Act, 1994, purely on an ad-hoc basis, for a period of 36 months with effect from 1 March 2009. One of the conditions of approval was that the final determination of the levy be made by GoI/Regulator after adequate consultation with users.

The Regulator (Airports Economic Regulatory Authority of India–AERA) after taking into consideration the revised final project cost informed by DIAL as ₹ 12,857 crore (as against ₹ 8,975 crore projected to the Ministry in October 2009), sought responses from stakeholders in its Consultation Paper of 21 April 2011. Airports Authority of India (AAI) in their submission dated 12 May 2011 before AERA stated that it was not in a position to make any further contribution towards equity. Further, DIAL too represented to AERA that as AAI have expressed inability to contribute further equity, it will not be possible to raise further equity without diluting the equity of AAI /breach of the trigger Debt-Equity Ratio.

Considering the above, the AERA permitted (14 November 2011) DIAL to levy DF at the rate of ₹ 200 per embarking domestic passenger and ₹ 1300 per embarking international

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<sup>▼</sup> A Joint Venture Company (JVC) incorporated under the Companies Act, 1956.



passenger (exclusive of statutory levies, if any) to bridge the funding gap. The levy commenced with effect from 1 December 2011.

While determining the levy of DF, AERA observed “Clause 3.3.1 read with clause 3.3.3.3 of the Shareholders Agreement (SHA) would seem to indicate that the private participants are obliged to acquire the equity shares, offered to AAI at the time of further capitalization and which it does not subscribe”. AERA also stated, “however, irrespective of the position whether other promoters can bring in further equity or not, in case they are presumed to be able to bring such equity, the same will lead to reduction in equity stake of AAI below the current 26 *per cent* level. Keeping in view of the provisions of the Companies Act, it will fundamentally alter the special position of AAI in the JVC, i.e. DIAL. The Authority feels that such fundamental alteration, at least at this stage, does not appear to be in public interest in as much as AAI is lessor of the airport and ought to have a special position in DIAL”.

Audit observed that AAI/MoCA\* did not bring to the notice of AERA, clause 6.1.1 as also clause 5.11.1, 5.12.1 and 5.13.2 of the SHA, emphasising the rights of AAI with respect to Reserved Board Matters and Reserved Shareholders Matters even when it holds at least 10 *per cent* of the equity capital of DIAL, thereby affirming AAI’s rights in respect of special resolution under the Companies Act, 1956 and Reserved Board Matters.

Clause 5.13.2 and clause 6.1.1 of the SHA are reproduced below:

**Clause 5.13.2:** A resolution of the Board of Directors shall be adopted by the affirmative vote of the simple majority of the Directors present at a meeting at which a quorum of the Board of Directors is present. Provided, however, that as long as AAI along with the AAI Nominees, in the aggregate, holds not less than ten (10) *per cent* of equity share of the JVC, any decision in relation to the Reserved Board Matters shall be considered as passed by a majority vote necessarily requiring the affirmative vote of the Directors nominated by AAI.

**Clause 6.1.1:** till such time as AAI along with AAI Nominees, in the aggregate hold at least ten (10) *per cent* Equity Shares in the JVC, the JVC (or any of its Directors, officers, agents or representatives) shall not give effect to any decision or resolution in respect of the Reserved Shareholders Matters, unless the same is approved by the affirmative vote of AAI.

The SHA defines ‘Reserved Shareholders Matters’ as “any shareholder resolution requiring the consent of not less than three-fourths (75 *per cent*) of the shareholders voting (special resolution) under the provisions of the Companies Act”. Therefore, it is seen that the SHA specifically protects the special position of AAI in the JVC till such point as AAI holds at least 10 *per cent* of the equity shares of DIAL and as such the rights of AAI would not be affected to any extent as per the provisions of the Companies Act even in case its equity was brought below 26 *per cent*. Similarly, clause 5.11.1, 5.12.1 and 5.13.2 further strengthen the position of AAI in the JVC by way of making it necessary for AAI nominee to be present to constitute quorum for Board meetings, bestowing upon AAI the right to nominate a member on any committee/sub-committee constituted by the

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\* Ministry of Civil Aviation

Board and making it mandatory for any decision in relation to ‘Reserved Board Matters’ to require the affirmative vote of AAI nominee Directors on the Board till such time as AAI holds 10 *per cent* of the equity in the JVC.

As the equity contribution of AAI in DIAL was ₹ 637 crore, by pegging AAI share holding at 10 *per cent* the other shareholders of DIAL could have contributed capital to the extent of ₹ 5733 crore (90 *per cent* of total paid up capital of ₹ 6370 crore) without affecting any of the rights of AAI either under the provisions of Companies Act 1956 or under the SHA. As the other shareholders of DIAL had contributed only ₹ 1813 crore towards the share capital of DIAL, the said shareholders could have brought in additional capital of ₹ 3920 crore to maintain the required debt-equity ratio and bridge the funding gap, thereby obviating the need to levy DF on the travelling public.

The Ministry of Civil Aviation (MoCA) is responsible for formulation of national policies and programmes for the development and regulation of the Civil Aviation sector in the country and it exercises administrative control over affiliated Public Sector Undertakings such as the Airports Authority of India. As per MoCA, its Vision is to “enable the people to have access to safe, secure, sustainable and affordable air connectivity services with World-Class Civil Aviation Infrastructure”. As such, MoCA/AAI are responsible for protecting the interest of the public at large and in this capacity, it was incumbent upon them to bring to the notice of AERA, the relevant provisions of SHA which would have provided for infusion of equity by the shareholders other than AAI to bridge the funding gap.

This failure on the part of MoCA/AAI led to levy of Development Fee amounting to ₹ 3415.35 crore out of which ₹ 2841 crore has been collected upto March 2014 and the balance amount will be collected upto April 2016.

MoCA replied (May 2014) as under:

- (a) AAI required funds for execution of projects at Chennai and Kolkata airports and upgradation of various facilities at select airports, as such it informed AERA about its inability to make any further contribution towards equity. AAI also indicated that the JVC i.e. DIAL could still maintain the trigger debt-equity ratio in terms of clause 3.3.1 of the Shareholders Agreement by way of infusion of funds in such form and quantity by the private participants without diluting equity shareholding.
- (b) AERA, while determining DF had considered all other means of bridging the funding gap for the Delhi airport project and had felt that it was not in public interest that the lessor of the Delhi airport, i.e. AAI, should have its shareholding reduced below 26 *per cent*. It was also felt by AERA that being a public sector undertaking, AAI would ensure greater support passenger interest. Hence, in order to have a balance between passengers interest safeguarding, the AERA had determined the amount of DF in respect of DIAL, keeping the AAI’s equity share at 26 *per cent*.

- (c) While determining DF, AERA had a reference to OMDA as well as the Shareholders Agreement in respect of DIAL. The Reserved Shareholders Matters mentioned in clause 6.1.1 of SHA and detailed under Schedule-4, did not cover many matters of operational as well financial nature and significance.
- (d) Prior to issue of order in the matter of review of levy of DF at Delhi airport, AERA had enquired from the private participants as well as AAI regarding the amount of equity/any other means of finance that they plan to employ for bridging the funding gap. At that stage the DIAL expressed its inability to infuse any further equity. AAI indicated that it was in a position to infuse ₹ 93 crore in the JVC. Infusion of additional equity by a shareholder can be done upon a cash call by the Company. However, DIAL has not made any cash call till date (May 2014).
- (e) While determining aeronautical tariffs in respect of Delhi airport, the amount of DF gets reduced from the Regulatory Asset Base (RAB<sup>\*</sup>). Thus the asset value on which DIAL is entitled for a fair rate of return stands diminished by the amount of DF. AERA has not allowed any depreciation on such DF funded assets. Hence, to that extent, burden on the travelling public through aeronautical tariffs, has been reduced permanently for all times to come through reduction of RAB on account of DF.
- (f) If AERA had not determined any DF and in case DIAL was also unable to infuse any additional equity, then there would have remained a funding gap for the project which would have impacted the timely investment in improvement of infrastructure/facilities in respect of Delhi airport and would also have resulted in the airport becoming economically unviable.

Reply of the Ministry is not acceptable in view of the following:

- (a) Proposal of AAI was contradictory as infusion of debt would have affected the debt-equity ratio while infusion of equity would have diluted the equity shareholding. As such the proposal of AAI was practicably not feasible.
- (b) Reply confirms that Ministry/AAI did not take cognizance of clause 6.1.1 of SHA which stipulates that AAI's affirmative vote is the deciding factor for all 'Reserved Shareholders Matters' irrespective of the quorum present and voting. Thus as per clause 6.1.1 till AAI holds 10 *per cent* of the equity in the JVC no decision or resolution on 'Reserved Shareholders Matters' can be given effect to unless it is approved by the affirmative vote of AAI. Effectively, this ensures all the rights and privileges of a shareholder holding 26 *per cent* or more equity. AAI/Ministry failed to bring up before the AERA the special protection given to AAI by clause 6.1.1 of SHA.

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<sup>\*</sup> *Regulatory Asset Base (RAB) refers to aeronautical assets and any investments made for the performance of Reserved Activities, owned by JVC but does not include CWIP, working capital, penalties, Liquidated Damages.*

Further, as per Clause 3.3.3.1 of SHA, AAI shall have option to subscribe for any subsequent capitalisation of JVC or otherwise. Clause 3.3.3.3 of SHA binds/obliges the private participants to acquire/subscribe for the shares not opted by AAI. Thus decision of AAI /MoCA not allowing dilution of equity below 26 *per cent* gave opportunity to the private participant to escape their obligation/responsibility under the SHA to raise additional equity/debt for the project.

- (c) The Ministry's reply while making mention of '*many matters of operational as well financial nature*' does not spell out such matters in specific terms. However, matters requiring Special Resolution as per Companies Act 1956 are exhaustive and cover all aspects of operational and financial nature. Therefore, Schedule 3 and 4 of SHA indicating Reserved Board Matters and Reserved Shareholders Matters (both require Special Resolution), respectively, and matters requiring Special Resolution as per Companies Act 1956 provide complete protection to AAI in financial, operational as also all important matters relating to the JVC. Hence reply is not acceptable.
- (d) DIAL's expressing inability to infuse any further equity indicated its intention of running the airport with minimal ownership funds. However, no action has been taken by MoCA/AAI on DIAL for non compliance to clause 3.3.1 and 3.3.2 of SHA.
- (e) MoCA did not provide any details or calculations to support their contention that burden on the travelling public through aeronautical tariffs, has been reduced permanently for all times to come through reduction of RAB on account of DF. The AERA, in their tariff order No. 3/2012-13 dated 24-4-2012 has worked out Net Target Aero Revenue of ₹ 7660.90 crore for Ist control period of five years (2010 to 2014) considering the element of DF reduced from the RAB. Audit worked out the Net Target Aero Revenue of ₹ 8638.06 crore approx. by using the same data as used by AERA but without considering the element of DF. It may be seen that if no DF would have been levied, the additional burden (during Ist control period) on the travelling public through aeronautical tariff would have been an increase of ₹ 977.16 crore approx. (₹ 8638.06 crore minus ₹ 7660.90 crore) i.e. ₹ 195.43 crore approx. per year. With passenger traffic at about 35 million during 2011-12, per passenger increase in aeronautical charges would be around ₹ 55 approx. only as against the DF of ₹ 100/ ₹ 600 being levied presently<sup>♦</sup>. With the increase in traffic in the coming years the burden on this account would have been negligible (projected traffic at 37 million for 2013-14).

The reply of the Ministry is at variance with its Press Note dated 16 October 2012, which stated that if funding gap was met in terms of equity infusion and proportionate raising of loans by the airport promoter including AAI, the Airport Development Fee could stand abolished.

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<sup>♦</sup>AERA revised with effect from 01.01.2013 the rate of Development Fee in respect of IGI Airport, New Delhi as ₹ 100/- per embarking domestic passenger and ₹ 600/- per embarking international passenger vide Order No. 30/2012-13 dated 28.12.2012

- (f) The fact that the special position of AAI in the JVC would remain unchanged even if its equity was diluted to 10 *per cent* was never brought to the notice of AERA by MoCA/ AAI.

### **2.3 Loss due to failure in taking timely action as per approved credit policy**

**AAI did not take action as per credit policy and allowed M/s Kingfisher Airlines Limited to continue its operations on credit basis even after withdrawal of the credit facility. AAI also did not act timely on the advice of MoCA to take all legal means beside encashing bank guarantee of the airline. This resulted in loss of revenue of ₹ 172.69 crore apart from loss of interest of ₹ 117.03 crore (up to February 2014).**

Airports Authority of India (AAI) provides aeronautical<sup>1</sup> and non-aeronautical<sup>2</sup> services at various civil airports in the country for which it charges fees and rent from an airline availing such services. As per credit policy of AAI, approved in 2007, bills are raised on fortnightly basis, and a credit period of 15 days, from the date of receipt of bills, is allowed to an airline subject to a security deposit equivalent to two months' billing of the airline. The credit policy further stipulated levy of interest at the rate of 12 *per cent* per annum on delayed payments.

M/s Kingfisher Airlines Limited (KFA) informed (13 April 2005) AAI, that they were scheduled to commence operations from 9 May 2005 and requested for grant of credit facilities for Route Navigation Facility Charges (RNFC), Terminal Navigation Landing Charges (TNLC), Landing and Parking Charges, Passenger Service Fees and other charges levied by AAI from time to time. AAI conveyed (28 April 2005) approval of credit facility to KFA subject to submission of a bank guarantee of ₹ five crore from a scheduled bank, in favour of AAI, towards security deposit. KFA deposited on 5 May 2005, the requisite bank guarantee and commenced its operations with effect from 9 May 2005.

KFA was persistently defaulting in making payments to AAI. Dues from the airline accumulated to ₹ 4.81 crore (against security deposit of ₹ 5 crore) up to 31 December 2005. The position of outstanding dues worsened after KFA took over, in June 2007, another airline, viz. Deccan Aviation. AAI took up the issue of pending recovery with KFA from time to time but the position did not improve. AAI informed (02 August 2007) MoCA that against guarantees of ₹ 25.70 crore available with them, outstanding dues against KFA had reached ₹ 36 crore. Ministry in response (5 September 2007) advised AAI to resort to all legal means beside encashing the bank guarantee (BG) of KFA. MoCA gave identical directions in August 2008 and October 2008, but AAI continued the credit facility to KFA till 31 May 2011, when the bank guarantee of ₹ 100 crore was encashed and AAI put operations of KFA on Cash & Carry basis with effect from 1 June 2011. Even after adjusting the proceeds of the BG, an amount of ₹ 217.31 crore remained outstanding as on 31 May 2011. In the meantime, the outstanding dues against KFA remained always in excess of the amount of security deposit held by AAI.

<sup>1</sup> *Aeronautical services means the facilities and services necessary for safe and efficient operations of the airport, movement and parking of aircrafts etc.*

<sup>2</sup> *Non-aeronautical services are related to passenger services at an airport.*

In spite of repeated commitments, KFA failed to clear the outstanding dues. AAI filed a suit against KFA in April 2012, at 63<sup>rd</sup> Court, Andheri, Mumbai, under Negotiable Instruments Act, 1881, for bouncing of cheques amounting to ₹ 136.22 crore. Director General of Civil Aviation (DGCA) initially suspended (October 2012) the license for operations of KFA and thereafter, cancelled the same in December 2012. Considering that the probability of recovery of dues was very low because of (i) stopping of commercial operations by KFA due to withdrawal of its flying permit/license by DGCA and (ii) in case of winding up of KFA, priority for payment would be last since AAI's debts were unsecured; AAI had written off, during year 2013-14, dues of KFA amounting to ₹ 172.69 crore. AAI had also filed (March 2014) a civil recovery suit before the High Court of Bombay for an amount of ₹ 294.57 crore (including interest up to 28 February 2014).

Audit examination revealed that:

- (a) AAI failed to take timely action against KFA for not adhering to the credit policy. KFA continuously defaulted in making timely payments and the amount of outstanding dues was more than the available security deposit during majority of the period of operations of KFA. AAI, however, encashed (May 2011) the available BG and put (with effect from 1 June 2011) KFA's operations on cash and carry basis, only after more than 5 years of default. Even after withdrawal of credit facility with effect from 1 June 2011, KFA was allowed to operate on credit basis leading to accumulation of huge outstanding dues against KFA.
- (b) MoCA failed to enforce execution of its own directions by AAI. Chairman, AAI had turned down the request made by CEO, KFA, in a meeting held on 18 November 2008, for allowing a considerable time for settlement of overdue, on the ground that all other private airlines were settling their dues, and special treatment only for Kingfisher Airlines was not possible. Scrutiny of minutes of 146<sup>th</sup> meeting of Board of Directors (which included representative/s from MoCA) held on 15 December 2011, however, revealed that:
  - (i) Contrary to the aforesaid stand taken by Chairman, AAI, MoCA/AAI, accepted the commitments made by CEO, KFA, for payment of overdue and allowed, as a very special case, KFA to continue the operations of the airline. Subsequently, the KFA failed to fulfill their commitments.
  - (ii) On the proposal to file a suit in the Court of Law for recovery of dues and for attachment of aircrafts of KFA for recovery of outstanding dues, no specific directions were given by the Board of AAI.

Thus, despite being aware that KFA was a willful defaulter, MoCA and AAI, both allowed the operations of the airlines to continue even beyond withdrawal of credit facility and did not take timely action to recover the mounting dues.

AAI replied (October 2014) that they had exercised all measures and controls along with invoking all legal aspects to realise the dues. It further stated, that MoCA was also informed of the process of liquidation of outstanding dues from time to time and various measures as suggested were also taken to realise the dues.

Reply does not absolve AAI of its failure in taking action as per provisions of credit policy and allowing KFA to continue its operations even after withdrawal of the credit facility. AAI also did not take timely action as advised by MoCA. This amounted to extending undue favour to KFA which resulted in loss of revenue of ₹ 172.69 crore apart from loss of interest of ₹ 117.03 crore (up to February 2014). Further, MoCA also failed to enforce its directives and diluted its stand by allowing KFA to continue operations.

The matter was reported to the Ministry in December 2014; their reply was awaited (March 2015).

#### **2.4 Non-recovery of cost of manpower and absence of provision to safeguard AAI's interests**

**As per JV agreement signed with Maharashtra Airport Development Company Limited (MADC), AAI deployed its manpower at Multi Modal International Passenger and Cargo Hub Airport at Nagpur (MIHAN) for Operation Support Period (OSP) of five years from 2009-10 to 2013-14 against payment of manpower cost by MIHAN India Limited (MIL). Against manpower cost of ₹ 64.99 crore incurred by AAI, MIL has paid an amount of ₹ 9.09 crore so far (January 2015). AAI also did not include any clause in the JV agreement to mitigate the financial risk in the event of non-absorption of AAI employees by the JV partner.**

Airports Authority of India (AAI) signed (18 December 2006) a Memorandum of Understanding with Maharashtra Airport Development Company (MADC) to establish a Joint Venture Company (JVC), MIHAN India Limited (MIL<sup>^</sup>) for development and operation of Nagpur International Airport for a period of 30 years. The MoU inter alia contained a provision that "the terms and conditions of the AAI staff working with the JVC shall be same as is being done in the case of Mumbai and Delhi Airports. The arrangement will be for five years and at the end of this period, the JVC shall absorb 100 per cent of the staff". The Memorandum of Understanding (MoU) was ratified by the Board of Directors of AAI and subsequently, Ministry of Civil Aviation (MoCA) approved transfer of Dr. Babasaheb Ambedkar International Airport, Nagpur to the JVC.

As per Clause 15.2 of the Joint Venture Agreement "as on date of transfer of Nagpur Airport to the JVC, all employees working at Nagpur airport (except the CNS/ATM personnel and related support staff) would be placed at the disposal of the JVC for a period of five years on the same terms & conditions of employment with AAI. At the end of the five years' period, all such employees shall be absorbed by the JVC on such terms & conditions which shall not be inferior to their existing terms & conditions which they are already enjoying as employees of AAI". After expiry of initial period of five years on 6 August 2014, the period was further extended up to 30 November 2014 and thereafter up to 31 March 2015.

Audit observed that:

- (i) With airport operations being handed over to a JV, AAI employees became surplus. With a view to mitigate such situation, AAI had inserted a provision in

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<sup>^</sup> *Multi Modal International Passenger and Cargo Hub Airport at Nagpur managed by MIHAN India Limited wherein AAI and MADC were having 49 per cent and 51 per cent equity, respectively.*

the OMDA whereby DIAL/MIAL had committed to pay retirement compensation in case AAI employees were not absorbed by the new operators. It was noticed that no such obligation was placed on MIL in the absence of which AAI would be burdened with the liability of employees who do not get absorbed under MIL.

- (ii) As on the date of transfer of Airport to MIL, 155 employees were at disposal of MIL. These employees are working presently with MIL but till date (March 2015) MIL has not finalized its HR Policy and Rules and Regulations for inviting offer of absorption. In absence of an offer from MIL, AAI was not in a position to obtain willingness of its employees to get absorbed in MIL.
- (iii) AAI has incurred an expenditure of ₹ 64.99 crore towards staff cost for the employees who are with MIL, for the period from August 2009 to January 2015. An amount of ₹ 55.90 crore (January 2015) is still outstanding against MIL on this account.

AAI stated (April 2014) that the outstanding dues were being consistently pursued with MIL. It further stated (March 2015) that MIL was finalising its HR policy which would be available soon and further action in the matter would be taken only on receipt of proposal from MIL.

The reply has to be viewed in the context of a meagre reimbursement of staff cost of ₹ 9.09 crore (March 2015) by MIL. AAI is silent on the issue as to how it proposes to deal with the financial liability of employees in the event of their non-absorption in MIL.

The matter was reported to the Ministry in November 2014; their reply was awaited (March 2015).

#### **Air India Charters Limited**

### **2.5 Unfruitful expenditure due to imprudent acquisition of aircraft on dry lease**

**Air India Charters Limited renewed dry lease<sup>1</sup> of four aircraft disregarding the rationale for acquisition of 18 new aircraft, shortage of crew and loss making routes which led to unfruitful expenditure of ₹ 405.83 crore between March 2011 to May 2014 towards lease related charges.**

Air India Charters Limited (Company) launched low cost operations in April 2005 with a fleet of three aircraft obtained (April 2005) on dry lease for a period of five years expiring by April - July 2010. Subsequently, the Company acquired 18 aircraft (new aircraft) between December 2006 and December 2009 on finance lease<sup>2</sup> backed by a guarantee by the Government of India (GOI). During the same period (2006-07 to 2009-10), AICL also

<sup>1</sup> *Dry lease: A dry lease is a cancellable lease at the discretion of lessor; the lessee being allowed to use the asset during the lease period by paying lease rental and maintenance reserve as per the lease agreement. The asset in case of dry lease should be returned to the lessor in the agreed working condition.*

<sup>2</sup> *Finance lease: Finance lease is essentially a financial loan to own the assets and lessee has the right to utilize the asset throughout its useful life while the lessor retains only legal rights over it during the lease period.*



acquired four more aircraft on dry lease expiring by March – May 2011. As on March 2010, the Company, thus, had a fleet of 25 aircraft.

The Company returned the three aircraft taken on dry lease in April 2005 on expiry of their lease term in April-July 2010. Besides, an aircraft of the Company was lost in an accident in May 2010. Thus, by August 2010, the Company had a fleet of 21 aircraft. The dry lease of another four aircraft was also due for expiry in March – May 2011. While deliberating the proposal for renewal of lease these four aircraft, the Board of Directors of Company (Board) felt (October 2010) that returning the aircraft might be a better option in view of aircraft utilisation of 10 hours per day against 12 to 14 hours per day expected from the brand new fleet, cancellation of flights due to non-availability of crew, loss making routes and idling of 4 out of 21 aircraft for maintenance/stand by. Hence, the Company felt that returning the dry leased aircraft would enable better utilisation of remaining flights and savings on cost.

However, the Company approved (January 2011) renewal of dry lease of the four aircraft on the ground of (i) critical reviews from the local press on withdrawal of flights from Kerala, (ii) demand from elected representatives from Kerala, (iii) upward trend in airline industry and (iv) proposed aircraft utilization of 10.9 hours/day and 11.2 hours/day in Winter 2011 and Summer 2012 respectively along with operating surplus. Accordingly, dry lease of the four aircraft was continued for three more years up to March/May 2014. Subsequently, the lease was not renewed and presently (January 2015) AICL has a fleet of 17 aircraft.

With regard to dry lease of four aircraft in 2006-10 and their continuation for additional three years during 2011-14, Audit observed the following:

- Acquisition of 18 aircraft was approved (June 2004) by the Company and the Ministry of Civil Aviation (December 2005) to replace the aircraft taken on dry lease. In fact, the Company/Ministry had decided that in case Boeing was able to commence deliveries of aircraft earlier than winter 2006/07, the number of aircraft to be taken on dry lease would be reduced accordingly. Hence, dry lease of four aircraft should have been terminated in tandem with receipt of aircraft on finance lease and certainly on expiry of the lease period in March - May 2011. This was also supported by the minutes of Board, which recognised (October 2010) the economy of issues against renewal of dry lease and proposed for return.
- The project report for acquisition of 18 aircraft had been approved (June 2004/December 2005) with a condition to achieve increased aircraft utilisation of 12.7 hours per aircraft per day. This utilisation level was not achieved by the Company. After approval to the renewal of dry lease for four aircraft in January 2011, significantly lower flight utilization of 10.5 to 11.0 hour per day was targeted by the Company in March 2011. The average daily utilization of flight hours/ block time  $\{(ADU (FH)^1 \text{ and } ADU (BT))^2\}$  was around 8.53 hours/ 9.85 hours during 2009-10. This reduced to 8.03 hours/ 9.25 hours in 2010-11 and further reduced to 7.73 hours/8.75 hours by 2013-14. Thus, even the reduced

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<sup>1</sup> *ADU(FH): Average Daily Utilisation (Flight Hours)*

<sup>2</sup> *ADU(BT): Average Daily Utilisation (Block Time)*

targets for aircraft utilisation as envisaged by the Company in March 2011 were not achieved. In fact, the utilisation levels fell consistently bringing to question the rationale for continuance of dry lease of the four aircraft after the expiry of their lease period in March 2011 even as the low level of aircraft utilisation added to the losses of the Company.

Thus, renewal of dry lease of four aircraft till May 2014 without factoring in shortage of crew, loss making routes and pay-load restrictions was against the rationale of acquisition of 18 new aircraft and led to unfruitful expenditure of USD 76.39 million<sup>1</sup> (₹ 405.83 crore) between March 2011 and May 2014 towards lease rentals, contribution to maintenance reserves and re-delivery charges.

The Company, in reply, attributed (October 2014) the under utilisation of aircraft to non-availability of pilots due to (i) resignation of expatriate pilots during 2011-12; (ii) implementation of Civil Aviation Requirement (CAR) on Flight and Duty Time Limitations for crew effective from February 2012; (iii) pilot 'strike' during May 2012; and (iv) difficulty in recruiting fresh pilots due to unattractive salary and base of operation being non-metro stations.

The reply is not tenable in view of the following:

- The Board felt (October 2010) that in order to achieve better utilisation, returning the aircraft might be a better option in the prevalent situation such as shortage of crew, loss making routes, payload restrictions etc. The Company was well aware of the crisis of crew shortage but it still went ahead with the renewal of lease which was not only against normal prudence but also violated the objective of acquiring the new aircraft as envisaged in the feasibility report for acquisition of the new aircraft.
- As regards time limitations imposed under CAR effective from February 2012, ADU (FH)/ ADU (BT) during 2012-13 was 6.53/7.43 hours respectively. However, this could have been better managed had the Company not renewed the dry lease of four aircraft. After discontinuance of dry lease of the four aircraft between March and May 2014, ADU (FH)/ADU (BT) during from April 2014 to December 2014 improved from 7.73/8.75 hours in 2013-14 to 9.31 hours/10.58 hours during 2014-15 (upto December 2014).
- Further RASK<sup>2</sup> and CASK<sup>3</sup>, the key performance indicators for operations during 2012-13 to 2014-15 (upto December 2014) of AICL are tabulated below:

Year	RASK	CASK
2012-13	₹ 2.51	₹ 2.48
2013-14	₹ 2.80	₹ 2.45
2014-15 (upto December 2014)	₹ 3.24	₹ 2.14

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<sup>1</sup> Includes Lease rentals for the period April 2010 to May 2014 - USD 64.38 million, Contribution to Maintenance Reserve, net of actual expenditure recouped – USD 4.51 million and Redelivery charges on termination of lease – USD 7.50 million.

<sup>2</sup> RASK – Revenue per available seat kilometre.

<sup>3</sup> CASK – Cost per available seat kilometre.

As can be seen from the table above, revenue earned per kilometre rose sharply even as the operating cost per kilometre fell during 2014-15. This was on account of, *inter alia*, reduction in number of aircraft.

Thus, the Company ended up incurring unfruitful expenditure of ₹ 405.83 crore between March 2011 and May 2014 on lease related charges on account of improper renewal of dry lease of four aircraft.

The matter was reported to the Ministry in December 2014; their reply was awaited (March 2015).

### **2.6 Avoidable expenditure on ferry flights to Mumbai for maintenance**

**Air India Charters Limited (AICL) delayed establishment of hangar project at Thiruvananthapuram and consequently performed the flight maintenance at Mumbai, resulting in avoidable expenditure of ₹ 18.07 crore.**

With a view to (a) overcoming constraint of space and difficulties relating to ground movement of aircraft at Mumbai and (b) reducing expenditure on ferrying ‘maintenance flights’ to Mumbai, Air India Limited (AIL) decided in November 2004 to establish a hangar at Thiruvananthapuram for carrying out major ‘C’ checks, structural repairs of B-737 aircraft to be operated by its subsidiary *viz.* Air India Charters Limited (AICL) and other narrow body aircraft owned by AIL as well as undertaking third party maintenance work at the facility. AIL had anticipated that engine overhaul, replacement of landing gears, APU overhaul, structural repair of aircraft and components would continue to be carried out at Mumbai for which estimated three flights per week to and from Mumbai would continue and, thus, establishment of hangar at Thiruvananthapuram would reduce number of ‘maintenance flights’ from 18 to three per week.

AICL launched a low cost airline with B-737 aircraft in 2005 under the brand name Air India Express. It operates its flights from Southern India. As no maintenance facility was available in the South, it had to ferry flights to Mumbai for maintenance of its fleet.

As per internal arrangement between AIL and AICL, it was decided (2008) that civil construction work for the hangar would be done by AIL and equipment would be procured and commissioned by AICL. Land for the hangar was allotted free of cost to AIL by the Kerala State Government in November 2005 subject to the condition that AIL should start physical construction before November 2006. However, construction works were delayed due to delayed payment to contractors resulting in repeated demobilization and remobilization of work force and inter-dependence of works of multiple contractors as against the initial idea of having a single contractor for most of the work.

The civil construction work was finally completed by AIL in June 2012 after incurring an expenditure of ₹ 78.16 crore. Clearances/approvals from Thiruvananthapuram Municipal Corporation for occupancy, Pollution Board, Department of Factories and Boilers, Fire Department, *etc.* necessary for full-fledged operation of the hangar were obtained only by September 2012.

The cost of the equipment required for the hangar was estimated by AICL at ₹ 21 crore<sup>1</sup>, against which procurement activity was initiated as early as 2008. Against this, equipment (58 items) worth ₹ 4.99 crore only has been procured till date (January 2015). AICL did not place orders for equipment valuing ₹ 10 crore<sup>2</sup>(149 items) due to delay in construction of the hangar and space constraints. AICL decided to stop purchasing further equipment till the hangar jobs were completed. AICL has not procured the remaining equipment till January 2015.

The hangar was partially commissioned in January 2013 to carry out 'C'-checks and phase checks. The shop activities (wheel shop, brake shop, pressure vessel shop and structural repair facility) except battery shop had been partially commissioned by May 2014.

Audit observed the following:

- The intended equipment (estimated cost of ₹ 21 crore) had not been procured by the Company. Equipment worth ₹ 4.99 crore alone were purchased with which some shops were partially operated.
- Even among the equipment valued at ₹ 4.99 crore, equipment (32 items) worth ₹ 2.72 crore had been commissioned since 2012, 19 items worth ₹ 1.12 crore (pertaining to wheel, brake and pressure vessel shops were commissioned only in May 2014) and 7 items worth ₹ 1.15 crore (pertaining to hot bonding and system shops) were either not commissioned or were to be transferred to Thiruvananthapuram from Mumbai.
- Even after incurring an expenditure of ₹ 83.14 crore on the hangar project by AIL and AICL over 2007-14, AICL had to ferry all 'maintenance flights' to Mumbai till January 2013 owing to tardy implementation of the hangar facilities.
- Despite partial commissioning, the number of 'maintenance flights' to Mumbai registered an increase of 12 *per cent* in 2013-14<sup>3</sup>, defeating the very objective of establishing the hangar at Thiruvananthapuram in order to overcome the constraint of space and difficulties relating to ground movement of aircraft at Mumbai.
- The Company ferried 2522 flights to Mumbai for maintenance during October 2011 to September 2014 (2011-12: 671 flights, 2012-13: 771 flights, 2013-14: 866 flights and 2014-15: 214 flights) against envisaged ferrying of 468 flights (156 flights per year) to Mumbai for major maintenance.
- Most of the shops so far commissioned were partial and the desired objective of setting up the hangar could not be achieved. The avoidable operating cost incurred on account of ferrying maintenance flights to Mumbai from October 2011<sup>4</sup> worked out to ₹ 18.07 crore considering the operating cost, revenue earned

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<sup>1</sup> Estimates were based on 2007 prices

<sup>2</sup> Hot bonding shop (30 items), Structural Shop (77 items), Welding Shop (13 items) and Machine Shop (29 items) and the remaining amounts was required for development, modification of different shops.

<sup>3</sup> From 771 in 2012-13 to 866 in 2013-14.

<sup>4</sup> As parallel taxi was ready from September 2011, the loss worked out from October 2011.

including cargo and excess baggage\* and scheduled maintenance of 3 flights per week to Mumbai during October 2011 to September 2014.

Thus, even after incurring an expenditure of ₹ 83.14 crore on the hangar project by AIL and AICL over 2007-14, the Company had to ferry all 'maintenance flights' to Mumbai till March 2013 thereby incurring a loss of ₹ 18.07 crore.

AICL stated (October 2014) that:

The delay in commissioning the hangar was attributable to delays caused in vacating the plot *i.e.* rubber factory, boundary dispute with Airports Authority of India (AAI), obtaining approvals from various authorities and delay in executing the work by the contractors. AICL added that there was greater potential to generate traffic in longer routes than operating in shorter routes within Southern region which commenced subsequent to implementation of the hangar at Thiruvananthapuram.

Reply of AICL is not acceptable in view of the following:

- There was no mention of hindrances by AICL when its representatives visited the site in March 2005. Soon after laying the foundation stone (November 2006), the Company undertook the construction work, which indicated that hindrances did not impact the construction work.
- The defunct rubber factory was outside the allotted land and the boundary dispute with AAI towards construction of taxi track did not affect the hangar construction as is evident from internal notes (April 2008) of AIL Project Committee, which stated that the construction work at the project site was proceeding as per plan. Furthermore, pending settlement of boundary dispute and compensation of land, the project was declared as 'completed' by the project committee in February 2012.
- The fact remains that it was AIL's inability to efficiently plan and execute the work through a single contractor by providing necessary resources on time and ready the site as planned that contributed to the delays.

The matter was reported to the Ministry in November 2014; their reply was awaited (March 2015).

## **Air India Limited**

### **2.7 Review of implementation of Passenger Reservation System and RAMCO Inventory System**

#### **2.7.1 Introduction**

Passenger Reservation System and RAMCO inventory system are two of the significant information systems in use in Air India Limited (Company). Both information systems are presently functional (PRS since February 2011 and RAMCO since May/ November 2012).

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\* Five per cent of Total passenger revenue of ₹ 239.93 crore.

**Passenger Reservation System:** Passenger Reservation System (PRS), end-to-end software, is outsourced to the ‘Society for Information Telecommunication Agency’ (SITA) and the servers (main and backup) are located at Atlanta, USA. The estimated cost of the project was US\$ 185.925 million (₹ 860 crore) spread over 10 years. The system was implemented in February 2011.

The PRS system aims at automating the reservation, ticketing, boarding and baggage functions for Air India. It consists of the following three major functions:

- **Reservation system** which covers booking of tickets through various modes (Website, authorized agents, AI’s booking windows or through other portals)
- **Departure Control system** (DCS) which covers activities related to baggage and boarding.
- **Frequent Flier Program** (FFP) which is a reward programme for passengers.

**RAMCO:** Implementation of RAMCO system for Maintenance, Repair and Overhaul (MRO) activities was initiated (May 2010) at a cost of ₹ 50 crore to meet primary requirements of quality control and technical services, line maintenance, inventory management of the combined fleets for the Company and its subsidiaries. The system was implemented in May and November 2012 in Mumbai and New Delhi respectively. It covers the following activities:

- **Procurement process** including planning, purchase, receipt of material and settlement of bills.
- **Inventory Management** which comprises of classification, issue, receipt, return and adjustments of inventory, physical verification.
- **Repairs and maintenance** based on MRO requirements.

Besides being core functional areas, the information from PRS and RAMCO systems are incorporated into the SAP system for financial accounting.

### **2.7.2 Audit Objectives and scope**

Audit was conducted to review performance of the Company in implementing PRS and RAMCO systems to seek assurance on the following:

- Whether objectives of the two information systems have been achieved;
- Whether the business rules of the Company have been effectively mapped in two information systems; and
- Whether the two information systems have been efficiently integrated with SAP financials.

Transactions for the period 2011-12 to 2013-14 were covered in the audit.

### **2.7.3 Audit Criteria**

Audit criteria was derived from Corporate Rules, Government guidelines, amendment parameters, best practices and System Controls envisaged in the systems in the respective agreements with Vendors.

### **2.7.4 Audit findings**

#### **2.7.4.1 Passenger Reservation System (PRS) - Non finalisation of service level agreement (SLA) with vendor**

The vendor (SITA) had agreed to a Service Level Agreement (SLA) for monitoring the system performance in its bid. However, the SLA is yet to be finalized and adopted (June 2014) on account of difference between the Company and SITA regarding methodology for measuring performance. Pending resolution of this dispute, the vendor, SITA reports on key performance parameters (uptime and response time) as per its proposed SLA using its own methodology for Passenger Service System (PSS), Internet Booking Engine (IBE) and Frequent Flyer Programme (FFP).

Audit noticed that while response time of 1.50 seconds has been achieved, the system availability and uptime, as worked out by the vendor, has been consistently below the SLA benchmark of 99.97 *per cent*; the service availability at times went down to 99.35 *per cent* in 2011-12, 99.16 *per cent* in 2012-13 and 99.41 *per cent* in 2013-14.

The Company agreed with the observation. In the Exit Conference (12 November 2014), the Company informed that penalties were being levied on the vendor in line with the agreement for disruptions and outages.

The Company needs to take necessary steps to improve the uptime of PSS as this not only impacted its revenue but also affected its reputation.

#### **2.7.4.2 Delay in uploading pricing decisions**

For booking and ticketing through PRS, information on pricing, flight schedules, routes and seats availability are essential inputs. While routes and flight schedules were fed into the system by the Company directly, the pricing information was worked out manually by the Company and transmitted to a vendor. The vendor codified these changes and uploaded it into the Airline Tariff Publishing Company's (ATPCO) system (a common system for all airlines) which made it available globally. The PRS got the pricing input from ATPCO.

The agreement with the vendor codifying and uploading prices stipulated that requests with priority '1', being TOP PRIORITY, should be distributed within 4 hours, those with priority '2' should be distributed within 8 hours and requests with priority level '3' should be distributed within 24 hours.

During April 2012 to May 2014, the Company made 5,017 price revision requests to the vendor. Audit noticed delays of more than one day in 1,876 price revisions (37 *per cent* cases). Delay of more than 30 days was noticed in 19 cases including a delay of 82 days in a single case. Of the 1,876 cases of delay, 100 were Priority 1 cases, *i.e.* where the time

period prescribed for uploading the revised prices was 4 hours. Even here, around 30 *per cent* requests were delayed by more than 5 days.

The Company is a price follower in the market and reacts to the market in fixing its price and giving special fare offers. Unless such changes in fares were quickly implemented, they would not have the desired impact on revenue, as by then prospective customers might have already booked with competitors. The delay in uploading the pricing decisions would be detrimental to the airline's business.

It was noticed that PRS had a tool which allowed uploading of pricing information directly rather than be routed through a vendor. This had not been acquired by the Company. Manual intervention by a third party (the vendor) also increased the risk of errors in data entry. Audit noticed an instance of incorrect data entry by the vendor in uploading the price revision. The fuel component in the pricing was incorrectly discontinued for an hour on 19 February 2013. The omission resulted in a loss of ₹ 34.48 lakh for the single hour. Thus, the manual intervention exposed the Company to an additional degree of risk.

The Company replied (November 2014) that a Committee was being constituted to evaluate acquisition of 'Pricing Tool'. In the Exit Conference, the Company accepted the concern and replied that the process was on for acquiring PRS pricing tool, to rectify this problem.

While appreciating the efforts of the Company for expediting price changes and ensuring accuracy, the critical concern regarding errors and delays in manual intervention would remain so long as the key element of pricing remains outside the scope of PRS.

#### ***2.7.4.3 Non adherence to credit policy led to accumulation of outstanding dues***

The Company offered credit sales to various agents and entered into agreements with them for promoting regional sales. The Company had a policy of terminating the contracts for credit sales with the defaulting agents, at any time on expiry of 30 days after the Company issued notice to the defaulter. The process of appointment and termination of credit contracts, sales reporting and monitoring of the remittance were not under the purview of PRS. The Company manually performed these functions and transmitted the termination requests appropriately to the vendor.

Audit found that there was an accumulation of outstanding dues of ₹ 113.94 crore from various agents for a period exceeding three years. No action had been initiated to block these defaulting agencies or to realize these amounts from defaulting agents. The defaulters continued to sell tickets through PRS, thereby further adding to the dues.

The Company replied (November 2014) that necessary action had been initiated to collect the dues. Alongside efforts to collect outstanding dues, action should also be taken to map the management policy correctly in PRS, thereby blocking further transactions from defaulting agents.



#### **2.7.4.4 Incomplete mapping of Business policy on Companion Free Scheme**

There were three classes of travel - the first, business and economy class. Within each class, however, there were various classification of tickets based on 'Reservation Booking Designator' (RBD). Typically there were three RBDs in first class, six RBDs in business class and 16 RBDs in economy class. The fare difference in tickets of different RBDs within the same class could be considerable (for example, the fare in 'Z' RBD in business class for AI 101-Mumbai-New York on 6 February, 2015 was 63 *per cent* of 'C' RBD in the same class).

The Company offered 'Companion Free Scheme' as a promotional measure valid on full IATA fares on all Ex-India international points (except SAARC) wherein the companion of the passenger was allowed to travel free of cost<sup>1</sup>, if the passenger had booked tickets under IATA full fare. The scheme specified RBDs for companion ticket depending on the RBD of the paid ticket in each class of travel.

The information on passenger travels availing CFS from January 2012 to December 2013 was reviewed and it was observed that in all 42 cases, the RBD of the free ticket was higher than the RBD specified in the scheme. This resulted in higher RBDs being blocked for sale, thereby decreasing potential for revenue sale.

The Company replied (November 2014) that there was no provision in PRS to restrict the RBD for CFS tickets.

The contention of the Company that PRS did not have the provision of booking tickets in specific RBDs was incorrect. At present all staff tickets were booked in specific RBDs and, therefore, it would be technically possible to restrict RBDs for CFS cases also which would safeguard the revenue interests of the Company.

#### **2.7.4.5 Irregularities in Departure Control Services of PRS**

As per the IATA requirements, boarding passes should be issued to passengers during check-in before boarding, with unique consecutive numbers for the leg of travel and in accordance with aircraft capacity. These boarding passes should also be linked to PNR and ticket numbers. It was, however, observed that boarding passes without numbers and without reference to PNR and ticket numbers were being generated by the PRS. Though PRS could block issuance of such boarding passes, this control had not been activated by the Company.

The Company informed that such boarding passes were meant for the crew in order to facilitate their entry into the aircraft, when their regular entry passes were unavailable.

Audit is of the opinion that this practice engendered a significant degree of risk to airport security and had a potential for misuse. As the system allowed printing of boarding passes without reference to PNR/ticket numbers, any intentional manipulation to allow boarding for unauthorised person, could not be ruled out. There had been media reports<sup>2</sup> on seizure

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<sup>1</sup> Excluding duties and taxes

<sup>2</sup> Times of India of 22 August 2013 titled, "CBI to probe fake LTC claims racket involving govt, PSUs."

of blank boarding passes in the LTC scam. Such risks could have been avoided by employing stringent validation controls in the PRS system.

The Company replied (November 2014) that DCS had now been modified to disable acceptance of passengers without associating PNR and e-tickets. The compliance would be watched in audit.

#### ***2.7.4.6 Incomplete controls to block violation of Free Baggage Allowance (FBA) policy***

The Company offered FBA based on travelling sector and class of journey. The rules in this regard were amended by the Company from time to time as mandated by IATA. As per the baggage policy, in domestic sector, 35 kgs of FBA was allowed for passengers travelling in Executive class and 20-15 kgs is available for Economy class.

In order to ensure mapping of the appropriate baggage rules in PRS, Audit analysed the data for one year (2013-14) on Delhi-Mumbai route in the domestic sector. It was noticed that out of 20,735 passengers who travelled during this period in this sector by AI 605 flight, baggage in excess of norms was allowed for 2,055 passengers. It was seen that in one instance, baggage upto 201 kgs was allowed against a single ticket, without noting it as excess.

Similar uncharged/ unreported excess baggage was noted on international route Delhi - New York also during test check. The system accepted baggage of upto 224 kgs against a single ticket without noting it as excess baggage. The baggage report generated from the system for the flight for the month of May 2014 also did not report any excess baggage.

The PRS system had the provision for building in the control regarding baggage limits which had not been activated by the Company. Implementation of the business rule, thus, was left to the discretion of the booking counter staff, who manually confirmed FBA based on number of passengers under same check-in and charged for the excess baggage if any.

The Company agreed with audit concern and stated (November 2014) that 'automated baggage rule' was under implementation.

#### ***2.7.4.7 Contact details of FFP members***

For maintaining customer relationship, vital contact details of members, such as mail address, business/home address, contact numbers, should be obtained by the Company from the members. However, audit analysis of data on frequent flyer members, revealed incomplete information in some crucial fields like contact numbers (1,04,129 cases), Home and Business address (9,545 cases) and e-mail address (13,498 cases) with the Company. This stymied the efforts of the Company in providing services to its FFP members.

The Company replied (November 2014) that improvements to data capture are in progress and the system is being upgraded. Further progress will be watched in audit.

#### **2.7.4.8 Non-automation of Frequent Flyer miles updation**

An analysis of implementation of FFP policy by the Company indicated that there were instances where the mileage points earned were not automatically updated into the PRS. This resulted in missing miles, resulting in dissatisfaction to the customers and members constantly approaching the Company for updating the missing mileage points.

While this could be due to omission or incorrect membership identity provided by the passenger, it was frequently on account of slippages by the airline:

- incorrect entry made by the airline staff at reservation or check-in level;
- omission in closing the flight preventing entries from departure control system into FFP; and
- non-matching of names between FFP membership and tickets.

The Company replied (November 2014) that onus to provide correct information was with members and also claimed that the success rate of automatic credits into the system was 85 per cent.

Reply is not convincing as success rate of automatic credits claimed by the Company was limited to the data which DCS could pass into FFP and not on the overall FFP miles earned.

#### **2.7.5 RAMCO inventory system**

##### **2.7.5.1 Planning and acquisition of RAMCO system**

###### **(a) Delay in implementation**

The Company's Board approved (November 2007) the capital expenditure of ₹ 27 crore towards implementation of RAMCO systems for MRO with a plan to complete the implementation in 18 months. There was a delay of more than 2 years in the tendering procedure. Owing to non-adherence of commercial procedure, the Company had to re-tender after CVC adversely commented on the tendering process.

Board re-approved (May 2010) the revised capital expenditure of ₹ 50 crore with anticipated completion by November 2011 resulting in additional cost of ₹ 23 crore. The system was implemented only in May 2012 (in Mumbai) and November 2012 (in New Delhi) with a delay of 6 months to 1 year.

###### **(b) Incomplete implementation**

Despite pending application changes on shop and line maintenance, Engineering change management, Hangar maintenance and shop maintenance, the 'Go live' was declared. This necessitated additional payment of ₹ 69.18 lakh (which was likely to increase further with future expenditure till the completion of agreed tasks) to the vendor for further changes in the system. Further, the vendor had committed for integration with Oracle Financials in its bidding document. With implementation of SAP Financials, the requirement was now for integration with SAP. However, integration of RAMCO and SAP systems is not covered in the contracted scope of work. The integration of RAMCO with SAP has not been achieved till date (January 2015).

The Company stated (November 2014) that the roll out into production was on hold due to taxation issues\* in RAMCO. The reply is not tenable in view of the fact that 'Go live' was declared before completion resulting in payment for any subsequent changes/implementation thereof. Moreover, the current RAMCO version implemented in the Company does not support integration with SAP. The Company would have to implement a higher version involving additional cost to achieve such integration.

#### **2.7.5.2 Lack of segregation of duties**

##### **(a) Purchase orders (PO) and repair orders (RO)**

Purchase Orders and Repair Orders issued from RAMCO system from May 2012 till June 2014 were analyzed in Audit. It was observed that out of 44,178 orders worth ₹ 5,449.21 crore issued during this period, 7,171 orders constituting 16 *per cent* of the orders, amounting to ₹ 136.04 crore, were created and approved by same user. It was also noticed that the system allows the same user who initiated and approved the order to receive the material. Four such instances where a single user initiated, approved and received the materials were noticed in Audit. Lack of segregation of duties and responsibilities left the system vulnerable besides rendering it non-compliant to the business rules of the Company as recorded in their Purchase Procedure manual.

The Company replied (November 2014) that user roles and authorizations were well defined in the system but due to shortage of staff the same had not been implemented completely.

Audit is of the opinion that circumventing segregation of duties in a computerized system due to shortage of staff compromised internal controls and suitable corrective steps were needed to be taken by the Company.

##### **(b) Stock corrections**

Stock corrections (changes in quantity or attributes of the material) were made in RAMCO inventory system manually based on periodical physical verification as well as changes in classification of the inventories. The related accounting entries (debit or credit adjustment entries) in the inventory register were carried out automatically by RAMCO system.

Audit analysis of the stock corrections for the period May 2012 to June 2014 revealed that a total 18,471 correction entries had been entered manually or passed automatically in the system. These corrections led to reduction in stock worth ₹ 50.19 crore in the inventory register. Out of these 18,471 corrections, 16,378 corrections were carried out manually during this period based on physical verification. Ninety-eight *per cent* of these corrections (16,152 corrections) had been initiated and authorized by the same user identity in contravention of the duties and responsibilities as stipulated in the Company's manuals.

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\* *Taxation issue due to establishment of Air India Engineering Services Limited (AIESL) as a separate entity and any inventory movement across the Company and its subsidiaries attracts taxes*

RAMCO system had made 2,093 automatic corrections in the inventory register during the same period. Variances were observed between the manual changes entered and their corresponding debit/credit adjustments passed by the system, indicating lacunae in the in-built system logic.

The incorrect assignment of segregation of duties coupled with the faulty system logic were the kind of significant risks that need to be addressed. An incorrect correction entry passed in the system affects the stock position, impacts inventory valuation and could result in wasteful procurement despite availability of stock.

The Company replied (November 2014) that the system had the capability to define authorization levels as per financial delegation and it was being implemented now. The corrective steps taken by the Company would be watched in Audit.

### **2.7.5.3 Inventory purchased in excess of the requirement**

The Purchase Procedure manual and policy guidelines of the Company described the sequence of events for procurement. Effective control over procurement would imply that the material(s) ordered were in line with the requirement and that the material(s) received were as per order. Undue purchases as well as short receipts compromise the financial interests of the Company.

Audit analyzed all the 27,485 PRs and their subsequent POs placed during the period May 2012 to June 2014 and found that in 10 *per cent* (2,835) of POs, the quantity ordered by the purchase department was more than the quantity requested by the user department.

The Company (November 2014) attributed it to minimum order quantity (MOQ), to avail price benefits and for combining multiple requests into a single order. It is, however, noticed that RAMCO system did not document MOQ for materials nor was the consolidation of multiple requests apparent in the system. Maintenance of a master file with MOQ details, reorder levels *etc.*, and linking it with actual procurement would enable the Company to better reap the benefits of automation. Besides, linking cases where purchase requests have been combined would improve the transparency of the system.

### **2.7.5.4 Discrepancies in intra stock transfers and receipts**

RAMCO inventory system was a combined system for the Company and its subsidiaries. Intra and Inter Company transfer of stock, therefore, was inbuilt into the system. Such transfers should be carried out with appropriate accounting of the stock movement and stock closing, to enable proper accounting of the same.

Audit analyzed the stock transfers during May 2012 to August 2012 and noticed that 3,547 stock transfer orders were issued for transferring 22,394 units of inventory worth ₹ 36.55 crore. Stock transfer orders, stock issued and received did not match as seen below:

<b>Stock transfer orders</b>	<b>Stock issued</b>	<b>Stock received</b>
22,394 units	21,628 units	18,366 units

As the above recorded status related to December 2014, *i.e.* after two years of issue of transfer orders and subsequent actions in May-August 2012, stock was not expected to be in transit. The significant difference (15 *per cent*), between the stock issued and received, was a matter of concern. The differences occurred in 208 stock transfer orders with the quantity transferred recorded as 3,364 units by the transferor unit while the corresponding quantity received was only 102 units, raising doubts on the location of the balance 3,262 units transferred during the limited three month period alone.

Audit also noticed that in case of 95 stock transfer orders issued during May – August 2012, the order had been treated differently by the transferor and the transferee. While the order had been designated ‘closed’ at the transferring end signifying its completion, the corresponding status recorded at the receiving end was either ‘partially received’ or ‘not received’. The opposite situation was also noticed where only partial transfer had been recorded at the transferring end while the receiving end depicted the material as having been ‘Completely Received’. This raises doubts on the integrity of the inventory register and left scope for the possibility of additional un-authorized transfers.

The Company replied (December 2014) that the audit analysis pertained to the migration period. The Company further stated that the stock transfers were three dimensional with three variables such as stock transfer order, stock transfer issues and stock transfer receipts, and hence, the transactions should be viewed with keeping transfer order and issue constant and receipts as variable.

Reply is not acceptable since audit analysis of the stock transfers during September 2013 also revealed similar discrepancies.

Suitable corrective steps are needed to be taken by the Company as these discrepancies could significantly affect the inventory accounting of the Company.

#### ***2.7.5.5 Improper inventory valuation***

During migration of inventory from earlier inventory systems of Air India and erstwhile Indian Airlines Limited, inventory held in stock, serviceable (₹ 256.46 crore) and unserviceable (₹ 527.37 crore), without applicable weighted average cost in the earlier system were migrated with the latest weighted average costs. Similarly, old inventory (₹ 57.76 crore) was brought back to stock by adopting latest weighted average rate. This altered the inventory position following migration. This had also been commented by the Statutory Auditors while auditing the accounts of 2012-13.

The Company replied (November 2014) that though the legacy data was updated and cleansed to some extent, it was not completed and to certain extent necessary correction entries were carried out during 2013-14. The reply is not tenable since this had resulted in overvaluation of inventory, contrary to the Accounting Policy of the Company as well as Accountant Standard 2.

#### ***2.7.5.6 Incomplete inventory migration***

During migration, the system was programmed to take the date of migration as date of last movement for opening balances, thereby impacting classification of inventory as non-moving/ slow moving. This resulted in continued dependency on the legacy system.

The Company stated (November 2014) that due to lack of fields to capture last movement date, RAMCO had updated the non-moving flag based on legacy data.

The reply confirmed the Company's continued dependence on the legacy system.

#### 2.7.5.7 Improper stock position of Companies

The Company implemented a single inventory system (RAMCO) to optimally utilize the inventory across the Company and its subsidiaries. There was a mis-match between the physical stock of spares inventory held in RAMCO against the Company and against its subsidiaries vis-a-vis the closing stock inventory accounted for as on 31 March 2013, in the books of respective companies, as given below:

**(₹ in crore)**

Company	RAMCO	Accounts	variation
Air India NB	716.42	740.96	24.54
Air India WB	447.11	421.26	-25.85
AICL	74.56	76.17	1.61
CD	9.54	9.23	-0.31
		<b>TOTAL</b>	<b>-0.01</b>

The Company stated (October/November, 2014) that precision of accounting was being maintained on a global basis and attributed the variation to changes in the part account group.

Reply is not acceptable as the part account group was coded for aircraft model, the type of inventory and were uniquely identifiable with the corresponding company through the company code available in the system. During any movement of inventory among the companies, the system should automatically update the concerned fields. Non-reconciliation of company-wise (Holding Company and the Subsidiaries) inventory indicated that the segregation possible through unique company codes had not been utilised by the Company.

The Company, agreeing with the observation, replied (November 2014) that the vendor had been approached to provide system executable accounting reports for finalizing the accounts for the year 2013-14 and also to provide monthly accounting entries tallying with the year-end summary. However, the issue was yet to be addressed as was evident from the continuance of discrepancies in the 2013-14 accounts:-

**(₹ in crore)**

Company	Inventory system	Accounts	variation
Air India NB	1995.72	1971.07	-24.65
Air India WB	775.03	790.19	15.16
AICL	177.18	186.75	9.57
CD	30.85	31.31	0.46
		<b>TOTAL</b>	<b>-0.54</b>

Suitable remedial action is needed to be taken by the Company to ensure that correct inventory position against the respective companies could be depicted, thus maintaining the integrity of accounts of the Company as well as its subsidiaries.

### **2.7.6 Integration issues**

#### **2.7.6.1 Non-integration of PRS and RAMCO with financial accounting system**

Both PRS and RAMCO systems provided essential data for preparing the financial statements of the Company. However, they did not have a direct interface with SAP Financials.

PRS generated the revenue information on passenger reservations and departures which was the major component of revenue of the Company. PRS system, however, did not have a direct interface with the SAP financial module and the information was transmitted from PRS via Kale revenue accounting system. Significant problems regarding functioning of Kale revenue accounting system had been noticed which impacted the financial statements of the airlines.

RAMCO provides the inventory details which needed to be incorporated in SAP for financial accounting. In the absence of an automatic interface with SAP, information was manually entered into SAP. During the year 2012-13 alone, 82,630 manual entries to the extent of ₹ 1,14,747.76 crore were passed into SAP Financials impacting several accounting heads such as inventory and its related provisions (₹ 974.73 crore), Fixed Assets and Depreciation (₹ 250.99 crore), Revenue From Cargo, Passenger, Mail, GSA (₹ 125.26 crore) and Travel Expenditure, Passenger Amenities and Hire Charges (₹ 1082.60 crore). Such large volumes of manual entries into SAP enhanced risk of errors and omissions.

The Company, agreeing (November 2014) with the audit observation, stated that non-integration of systems necessitated passing of manual entries in the system, apart from rectifications which necessarily needed to be passed manually. The Company also assured Audit that integration of RAMCO with SAP would be carried out in the next phase.

While the progress would be watched in Audit, the Company could have avoided such integration by implementing an integrated system from the start as such a system was available even then.

#### **2.7.6.2 Interface of passenger revenue with Financial Accounting**

Accounting Policy of the Company on revenue recognition was in line with Accounting Standard 9 which stipulated that passenger revenue was to be recognised when transportation service was provided *i.e.* on flown basis during an accounting year.

The data relating to passenger revenue processed by Kale consultants and reservations made for the month of March 2013 was analysed in Audit. It was observed that in 5,804 cases, date of travel was either prior to or subsequent to the accounting year 2012-13 and, hence, ought not to have been considered for revenue accounting for 2012-13. Besides, date of travel recorded in the revenue data processed by Kale consultants was inconsistent



with the ticket details as well as the actual flight details recorded in the PRS (as confirmed through a test check of some cases vis-à-vis the PRS system).

Audit noticed that the discrepancy occurred due to an error of Kale consultants. While Kale consultants had sourced the data from PRS, they had wrongly used the date field from the 'remarks' column rather than the 'date flown'. As a result, SAP Financials overstated the revenue for 2012-13 by ₹ 5.37 crore\* for travel beyond the accounting period, contrary to the policy of the Company.

The Company replied (July 2014) that as per standard industry practice, revenue was recognized based on the actual date of travel, considering the start of such flights that may cover more than a day. The Company also stated that the difference in travel dates were due to change of travel date by the passenger.

The argument of journeys starting on more than a day is not acceptable as Audit observed difference of more than 6 months in travel dates. In 926 instances the difference between the two dates was more than 2 days and went upto 365 days.

What is of concern is that the discrepancy had continued to affect revenue accounting even in 2013-14 as Kale consultants continued to use incorrect dates of travel. In 1305 cases, the date of travel was prior to date of issue of tickets indicated a flaw in revenue accounting.

#### ***2.7.6.3 Inconsistency in Revenue Accounting reports***

The Company was dependent on Kale Consultants for its revenue accounting as well as for generating MIS reports. Considerable differences were observed in the information received as MIS vis-à-vis revenue accounting information. The revenue recognized in the SAP Financials, as sourced from Kale consultants, for the year 2012-13 was ₹ 12,557.15 crore. During the same period, MIS reports provided by the same agency indicated a much lower revenue earned as ₹ 12,420.31 crore.

The difference of ₹ 136.84 crore generated from the two systems had not been reconciled. It is pertinent to note that amount of revenue earned as per MIS reports was lower than the final revenue recognized even though the MIS reports included an element of provisional revenue to cater to omission of any bookings 'not flown' into revenue accounting during the generation of MIS reports. The inconsistency in revenue earnings between the MIS reports and SAP accounting needed to be corrected.

Reply of the Company was still awaited (March 2015).

#### ***2.7.6.4 Retrieval of sales data – Productivity Linked Bonus (PLB)***

Productivity Linked Bonus (PLB) is paid by the Company to eligible agents based on international flown revenue generated by them. The Company depends upon Kale Consultants for this information as the PRS does not have necessary provisions for data

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\* Against the total revenue of ₹ 12,557.15 crore

extraction. Based on the data provided by Kale Consultants, qualified agents were offered PLB for 2012-13 by the Company.

Subsequently (October 2012), the Company realized that the data provided by the Consultant included tickets issued by them on other carriers as well. The revised data revealed that 22 agents earlier qualified were ineligible for PLB as they had not achieved the minimum productivity slabs.

The Company replied (November 2014) that since no reports were available in PRS, PLB was paid based on the reports obtained from outsourced vendor and assured that due care would be taken to randomly check the data to safeguard its financial interests.

### **Conclusion**

**Failure on the part of the Company to design and activate necessary controls in the Passenger Reservation System and the Inventory System, inappropriate customization, lack of validations in line with business processes and improper data migration resulted in the Company not achieving the full potential of the automated systems. The Company resorted to manual interventions and had a high degree of dependence on multiple vendors. Lack of an integrated system coupled with the manual interventions and weak security controls exposed the system to the risk of manipulations, unauthorized use and unreliability of data.**

#### **Air India Limited and Air India Charters Limited**

##### ***2.8 Avoidable expenditure due to under-utilisation of own simulators***

**Air India Limited and its subsidiary viz. Air India Charters Limited failed to optimally utilize its own simulators for want of proper planning and maintenance, which resulted in avoidable expenditure of ₹ 8.47 crore during July 2009 to March 2014 on purchase of simulator slots at third parties' simulators for training the pilots.**

As a part of the aircraft purchase agreements entered into by Air India Limited (AIL) and its subsidiary Air India Charters Limited (AICL) with M/s Boeing, USA in January 2009, the supplier (M/s Boeing, USA) agreed to provide simulators for B-777 aircraft to AIL and B-737-800 aircraft to AICL for training the pilots. The market price of the B-777 and B-737-800 simulators provided free of cost was ₹ 64.43 crore and ₹ 44 crore respectively. While the simulator for B-737-800 aircraft was installed in February 2007, simulator for B-777 aircraft was installed in December 2009.

AIL and AICL had been purchasing slots on B-777 and B-737-800 simulators from third parties for training their pilots for these aircraft. With the installation of own simulators, it was expected that the airlines would not be required to purchase simulator slots from third parties, thereby saving on costs and also hire out the spare capacity of simulators to third parties for earning revenue.

As per AIL, a simulator can be used optimally for 20 hours a day. Normally, a simulator session lasts for four hours and five sessions can be planned in a day. The remaining four

hours are kept for preventive maintenance. Thus, available hours on a simulator in a year are 7300.

Audit examination revealed that:

(i) Both the airlines planned utilization of lesser number of hours than the available capacity of the simulator. Actual utilisation was even less than the planned number of hours. Due to the gap between available capacity and actual utilisation, coupled with time lost in breakdown of the simulators (apart from the allowance of four hours per day for their maintenance), both the companies resorted to purchase of simulator slots from third parties. The available, planned, utilised and number of hours for which the simulators of third parties were hired by both the airlines during 2009-10 to 2013-14 is tabulated below:

Year	Available capacity (Hours) at the rate of 20 hours per day	Planned (Hours)	Percentage of available capacity planned	Utilised Hours	Percentage of available capacity utilised	Usage of simulator of third parties (Hours)
<b>B-777 of AIL</b>						
2009-10*	1800	856	48	826	46	230
2010-11	7300	5739	79	5196	71	939
2011-12	7320	6627	91	5884	80	730
2012-13	7300	6124	84	5039	69	1224
2013-14	7300	5146	70	4286	83	36
<b>Total:</b>	31020	24492	-	21231	-	3159

<b>B-737-800 of AICL</b>						
2009-10#	5680	3803	67	3597	63	361
2010-11	7300	5402	74	4616	63	418
2011-12	7320	6281	86	5437	74	20
2012-13	7300	5349	73	4076	56	0
2013-14	7300	4998	68	4389	88	0
<b>Total:</b>	34900	25833	-	22115	-	799

\* January 2010 to March 2010

#July 2009 to March 2010

Thus, the simulators were never planned for utilization for more than 91 *per cent* of their available capacity. While actual utilisation remained consistently lower than plan, the highest utilisation being 88 *per cent* of plan.

(ii) Considering an allowance of 6,204 hours<sup>^</sup> for preventive maintenance, AIL should have planned the simulators for 31,020 hours from January 2010 to March 2014. However, the airline planned it for 24,558 hours. Thus, there was significant gap of 6,462 hours between available and planned capacity of the simulators. Actual utilisation was further less by 3,363 hours than the planned hours. The gap was mainly due to unserviceable simulator, 'pull out/' 'no show' of crew/instructors, which indicated deficient preventive maintenance during the inbuilt allowance for 6,204 hours, defective planning and management on the part of the airline. As a result of reduction in number of B-777 aircraft from 20 in (2009-10) to 15 (2013-14) due to sale and grounding of aircraft, the

<sup>^</sup> At the rate of 4 hours per day.

training requirement for the related crew had reduced which increased the prospects of hiring out the simulator to other parties for earning revenue. However, AIL failed to take any initiative for hiring out the spare capacity (6,462 hours) to third parties.

(iii) Similarly, in the case of simulator available with AICL, the airline planned its simulator's utilisation for 25,833 hours, against the available hours of 34,900, thus, leaving a gap of 9,067 hours, in addition to 6,980 hours available for maintenance during July 2009 to March 2014. The airlines actually utilised the simulator for 22,115 hours with a further gap of 3,718 hours. In addition to 6,980 hours available for repairs/maintenance of the simulator, it remained unserviceable for 2,734 hours. For the gap of 9,067 hours between the available and planned capacity of the simulator, AICL also did not explore possibility of hiring out the simulator to third parties for earning revenue.

(iv) Instead of utilising the optimum capacity of their own simulators, both the airlines had purchased simulator slots for 3,958 hours from third parties *viz.* Jet Airways in Mumbai, Egypt Air Training Centre in Cairo and Emirates CAE Flight Training in Bangaluru during the same period (2009-10 to 2013-14) by incurring an avoidable expenditure of ₹ 8.47 crore.

AIL replied (February and November 2014) that:

- Available hours on the simulator cannot be utilised unless the requirement of the training days equals the same. This requires careful scheduling of crew and training of officers. If for any reason, any one of the above is 'out of sync', it will result in non-utilisation and the hours would lapse on that count.
- Mostly urgency for time bound refresher course and training for pilot proficiency check/instrument rating was dictated by Director General of Civil Aviation (DGCA).
- Induction of new aircraft and launch of line-operations puts immense strain on the training department. A total of 20 (Nos.) B-777 aircraft were inducted between 2007 and 2010. To ensure adequate utilisation of aircraft, it was considered better to train pilots at a higher and quicker rate using other simulator facilities. Also due to induction of B-787 aircraft, replacement pilots had to be trained.
- In house infrastructure, including simulators should be utilised to optimum capacity to ensure minimum cost of training. However, this also should be supported by adequate number of instructors. In the absence of sufficient numbers of instructors, it would not be possible to train large number of pilots within a limited period of time. Also AIL's attempts to recruit instructors have borne limited success.
- It was not financially viable to keep a large pool of instructors employed, since training was a cyclical phenomenon. That was also the reason that during peak times, it was prudent to hire outside simulators and complete training tasks within restricted time frames.

The reply is not acceptable in view of the following:

- The contention that induction of 20 B-777 aircraft put the AIL's training department under pressure and it led to outsourcing of training is not convincing as the very purpose of installing B-777 simulator in December 2009 at Mumbai was to impart training on regular basis to B-777 pilots as AIL was going to procure these aircraft.
- The argument of inadequate instructors is not established as AIL deployed its own instructors on Jet Airways simulator for training its pilots.
- Though the requirements of training as well as vacancies in 'flight instructor' cadre were well known to AIL, these posts were advertised for recruitment during April 2009 to January 2013. The airline advertised only 6 posts in February 2013, out of the shortfall of 74.
- In an airline such as AIL operating several types of aircraft, training is an ongoing process and not cyclical. Durations for Conversion Training<sup>1</sup>, Recurrency Training<sup>2</sup> and Line Training<sup>3</sup> are well defined by DGCA and fully within the knowledge of the AIL and, therefore, could be planned in advance.
- Outside simulator facility was used continuously and not exceptionally. Inability to coordinate between its own departments to ensure optimal utilisation of own simulator facility for fulfilling training requirements indicated the need for improvement in planning and management of training needs.

AICL replied (November 2014) that:

Under-utilisation of B-737-800 simulator was due to shortage of instructors and un-serviceability of the simulator due to various factors such as computer problems, shortage of spares, maintenance of air-conditioner, power fluctuations. AICL added that while the simulator was under service, training at outsourced party was resorted to, since training of pilots is a continuous critical function and non-adherence to it would lead to idling of pilots as well as under utilisation of aircraft. However, AICL assured that all efforts were being made to cut down on the use of outside simulator.

Reply of AICL substantiates the audit concern that simulators were not maintained properly for optimal utilisation despite an allowance of four hours per day towards preventive maintenance. Moreover, in contradiction to the reply regarding cutting down external simulator usage, audit observed that a tender had been floated on 27 October 2014 to invite bids from parties offering their simulators for wet/dry B-737-800 simulator for imparting training to AICL's pilots, which indicated that AICL was again planning for outsourcing simulator training.

Replies of AIL and AICL did not state specific reasons for planning the simulators for substantially less number of hours than their available capacity and raise serious concerns about the entire planning process for acquiring the simulators.

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<sup>1</sup> *For imparting training to pilots on a particular aircraft type.*

<sup>2</sup> *For validation of licences of pilots.*

<sup>3</sup> *For imparting training to qualified pilots on flying mode.*

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Thus, while their own simulators of the two airlines remained under-utilised due to lack of proper planning and maintenance, simulator slots were being purchased and the pilots were being sent for training to third party simulators which resulted in avoidable expenditure of ₹ 8.47 crore.

The matter was reported to the Ministry in December 2014; their reply was awaited (March 2015).