CHAPTER III

3. Compliance audit observations

Important audit findings emerging from test check of transactions made by the State Government companies/ Statutory corporations have been included in this chapter.

Government companies

3.1 Implementation of greenfield projects by five PSUs

Introduction

3.1.1 Government of Kerala (GoK) decided (April 2010) to implement five greenfield projects at a total project cost of ₹53 crore through five Public Sector Undertakings (PSUs). The projects, to be commissioned by December 2010, aimed at creating new facilities in manufacturing and to generate skilled work force. Status of implementation of these projects as on 31 March 2015 was as given below:

Table 3.1: Status of implementation of greenfield projects as on 31 March 2015

Sl. No.	Name of the Project	Implementing PSU	Annual Capacity	Project cost (₹ in crore)	Month of commissioning	Actual cost (₹ in crore)
1	House Wiring Cables Unit	TRACO Cable Company Limited (TRACO)	4.43 lakh coils of 90 meter	12.00	July 2013	8.25
2	Tool Room cum Training Centre	Kerala Small Industries Development Corporation Limited (SIDCO)	-	12.00	April 2013	10.87
3	Mini Tool Room cum Training Centre	Kerala State Electronics Development Corporation Limited (KELTRON)	-	12.00	December 2011	8.44
4	Machining[1] Unit of SIFL	Steel and Industrial Forgings Limited (SIFL)	1000 Metric Ton (MT)	12.00	December 2012	9.55
5	Liquid Crystal Display (LCD) Meter Production Unit	United Electrical Industries Limited (UEIL)	12 lakh units	05.00	Not Implemented	0.62
	Total			**53.00**		**37.73**

(Source: Government Order No. (GO(MS) No.103/2010/ID dated 30/04/2010)

[1] **Machining is the process of conversion of raw forgings to ready to fit components.**

Out of the five projects planned, four projects were commissioned after delays ranging from 12 months to 30 months, while LCD Meter Production Unit of UEIL at Palakkad was not implemented.

Against the estimated cost of ₹53 crore, the actual expenditure was only ₹37.73 crore. Less expenditure was mainly due to non-implementation of LCD Meter Production Unit, Palakkad and non-procurement of vital machinery and equipment envisaged in Detailed Project Reports (DPRs) of SIDCO, KELTRON and SIFL. Audit examined the implementation of greenfield projects to ascertain compliance to Government Orders, DPRs, Manuals of GoK and GoI.

Audit Findings

3.1.2 The DPRs of the four commissioned projects envisaged net profit of ₹15.70 crore up to March 2014. Despite investing ₹37.73 crore, these projects incurred aggregate loss of ₹11.59 crore up to March 2014. This was mainly due to non-achievement of envisaged turnover since the DPRs were prepared without carrying out proper feasibility studies. Further, there were deficiencies in DPRs, non-availing of Government assistance, etc*.,* by TRACO, SIDCO, SIFL and KELTRON as discussed in succeeding paragraphs.

Planning of projects

Imprudent selection of implementing agencies

3.1.3 As per the Government Order (GO), one-third of project cost of three[2] projects, totaling ₹12 crore was to be financed out of their own resources/ loans from financial institutions. In the case of UEIL, the project cost of ₹5 crore was to be financed by equal equity participation (₹2.5 crore) and soft loan (₹2.5 crore) from Malabar Cements Limited[3] (MCL). GoK selected TRACO, SIDCO, KELTRON and UEIL, PSUs with poor track record of performance and continuous operating losses, for implementing four projects. These PSUs had an aggregate accumulated loss of ₹310.25 crore at the end of March 2010. TRACO, SIDCO and KELTRON failed to comply with the Government Order on financing the project. Consequently, GoK had to extend financial assistance to TRACO and SIDCO and certain vital machinery was curtailed in respect of SIDCO and KELTRON as explained in *Paragraph 3.1.6.*

Thus, selection of the projects without proper feasibility study and entrustment of their implementation to PSUs with poor track records was not prudent.

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[2] **Units of TRACO, SIDCO and KELTRON.**
[3] **A Public Sector Undertaking in Kerala engaged in manufacture of cement.**

Preparation of feasibility report

3.1.4 According to Project Implementation Manual (PIM) published (1989[4]) by Ministry of Statistics and Project Implementation, Government of India (GoI), approval for any public investment should be preceded by a feasibility report. The feasibility report should focus on whether the project was conceptually sound and feasible for its economic benefits as well as financial returns.

During scrutiny of records, it was noticed that the decisions to set up the greenfield projects were not backed by feasibility studies.

Deficient Detailed Project Reports (DPR)

3.1.5 As per the PIM, preparation of an accurate and realistic DPR is the foremost activity for any project. The DPR should contain complete break up of all components of the project with specific time schedule and firmed up costs, market demands, pricing, location, etc. It is used as an instrument for controlling and monitoring the physical as well as financial progress of the project. The DPR must address all issues related to the justification, financing and implementation of the Project. The services of professional bodies could be hired for preparation of the DPR, if considered necessary.

The DPRs for Machining Unit (SIFL), House Wiring Cables Unit (TRACO), LCD Meter Production Unit (UEIL) and Mini Tool Room cum Training Centre (KELTRON) were prepared in-house by the implementing agencies and that for Tool Room cum Training Centre (SIDCO), it was prepared by engaging a chartered accountant (GSPU Associates, a regular consultant of SIDCO). Lack of expertise and adequate due diligence on the part of the agencies and consultants was quite evident from the deficiencies in the DPRs and market projections as discussed below.

- Against financing pattern[5] prescribed (April 2010) in the GO for the projects of SIDCO and KELTRON, DPRs were prepared envisaging 100 *per cent* equity contribution from the GoK. Similarly, in respect of the project of SIFL, prescribed funding pattern of own funds and loans from financial institution was in the ratio of 1:1. DPR was, however, prepared envisaging 100 *per cent* borrowed funds. Consequently, capital investment was restricted by curtailing procurement of vital machinery as explained in *Paragraph 3.1.6.*

  KELTRON replied that the DPR was initially prepared envisaging 100 *per cent* financial support from the GoK, but the decision on fund allocations was received later.

  The reply was not acceptable as the deviations from GO was due to non-revision of DPRs which were prepared before receipt of GO on funding.

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[4] **Revised in June 2010.**
[5] **Ratio of 1:1:1 (equity contribution and soft loan by MCL and own fund/ loan from financial institution).**

- Estimates prepared for the civil works in the DPR were not based on the actual requirements and were made without considering the machine specifications. This necessitated construction of additional space and facility, which were not envisaged at the time of estimation. Consequently, actual cost of execution of civil works increased from ₹0.92 crore to ₹2.36 crore (157 *per cent* increase) in respect of SIDCO and from ₹1.40 crore to ₹4.55 crore (225 *per cent* increase) in respect of KELTRON.

  SIDCO and KELTRON while agreeing with audit observation replied that plinth area envisaged in the DPR had no rationale with the plinth area actually required and were prepared without considering the size and dimensions of the machinery and area to be occupied by the machinery.

- DPR of House Wiring Cables Unit of TRACO envisaged production of 11.08 lakh coils of 90 metre for the first three years (annual production capacity- 4.43 lakh coils of 90 meter size) whereas actual production for the first three years was only 1.34 lakh coils of 90 metres. Against this production, actual sales were 1.31 lakh coils of 90 metres.

  It was noticed that annual production capacity was pegged (2010) in DPR at 4.43 lakh coils of 90 meter size based on the market study report received from KITCO in July 2004. Due to fixing annual production capacity based on an outdated market study, TRACO faced problems in marketing and TRACO could not find enough dealers for selling its products. TRACO was using its three outlets for marketing its products.

  TRACO replied (October 2015) that efforts were being made to boost sales through registration with Government Departments like, Public Works Department and appointment of marketing agents.

- Sales turnover and breakeven point were not projected while preparing the profitability analysis in the DPR of Tool Room cum Training Centre of SIDCO.

Non-compliance to Government Orders on funding of projects

3.1.6 As per the GO, out of project cost of ₹12 crore each in respect of TRACO, SIDCO and KELTRON, ₹8 crore was to be financed by MCL and the balance ₹4 crore each by the implementing agencies. In the case of SIFL, the project cost of ₹12 crore was to be equally funded out of own resources and loans.

MCL advanced its share of ₹24 crore (₹12 crore as equity and ₹12 crore as loan) in the year 2010. MCL also advanced ₹1 crore as equity to abandoned project of UEIL. The implementing agencies, however, failed to comply with the provisions of the GO on financing the projects as shown in *Table 3.2*:

Table 3.2: Status of funding

Name of the Implementing agencies	Required funding (₹ in crore)		Actual funding (₹ in crore)		Impact
	MCL	Own	MCL	Own	
TRACO	8	4	8	Nil	GoK had to extend financial assistance of ₹4 crore by way of working capital loan. This loan together with accrued interest was subsequently converted (November 2013) into equity.
SIDCO	8	4	8	0.87	GoK had to give loan of ₹2 crore. Capital investment was restricted to ₹10.87 crore curtailing procurement of vital machineries required for the project.
KELTRON	8	4	8	0.44	Capital investment was restricted to ₹8.44 crore curtailing procurement of vital machineries required for the project
SIFL	0	12	0	9.55	SIFL contributed ₹6.55 crore against required contribution of ₹6 crore as per the GO. Loan from financial institutions was arranged to the extent of ₹3 crore only. Consequently capital investment was restricted to ₹9.55 crore curtailing procurement of vital machineries required for the project.
UEIL	5	0	1	0	Project cost of ₹5 crore was to be financed by equity participation and soft loan from MCL in the ratio of 1:1. As the project did not take off, ₹4 crore was refunded to MCL, keeping the balance of ₹1 crore with the Company.

In the absence of required funding by the implementing agencies, implementation of the greenfield projects was curtailed and limited to the funds provided by MCL, a profit making PSU, as it contributed ₹25 crore out of the total expenditure of ₹37.73 crore incurred on the greenfield projects.

Implementation of projects

Issues noticed in the implementation of the greenfield projects are discussed below.

Deviation from DPR

3.1.7 During implementation of greenfield projects, implementing agencies deviated from the DPR as discussed below.

- As per the DPR, the Machining Unit of SIFL should be located near the promoterҫs existing company to reduce the transportation cost. Machining Unit of SIFL was proposed to process the raw forgings manufactured in its Forging Unit at Athani. SIFL had eight acres of un-utilised land adjacent to its Forging Unit at Athani. The Company, however, set up the machining unit in three acres of land taken (August 2010) on lease at Shoranur, which was 22 km away from Athani for a period of 99 years at the rate of ₹30,000 *per annum* with 10 *per cent* escalation every five years**.** The requirement of setting-up of

machining unit at Shoranur was taken in the meeting (March 2010) chaired by Hon'ble Minister for Industries and Commerce, GoK.
The Machining Unit of the Company was located at a distant place despite having suitable land near the Forging Unit. As a result, after commissioning of the Machining Unit, the forged material (811.07 MT) had to be transported from Athani to Shoranur for machining purpose by incurring avoidable expenditure of ₹5.32 lakh (up to February 2015) towards transportation charges and avoidable committed liability on lease rent of ₹30,000 per year.

Management replied (May 2015) that the Unit was set up at Shoranur at the instance of GoK. The reply was not acceptable as the Company should have brought to the notice of GoK the extra expenditure in setting up the project at Shoranur but it had failed to do so.

- DPR of Tool Room cum Training Centre of SIDCO envisaged procurement of machinery worth ₹10.31 crore for the project. The Management, however, did not procure machinery worth ₹3.39 crore.

  The Management replied that non-procurement of machinery was due to shortage of funds that resulted from the increased cost of construction.

  The reply was not acceptable as the increased cost of construction was due to constructing double the area envisaged in DPR. Further SIDCO had brought only ₹0.87 core against its share of ₹4 core in the project cost.

- Lump sum provisions for electrical installations were made in the DPRs without any drawings and estimates. As against ₹18 lakh (SIDCO) and ₹14.50 lakh (KELTRON) for electrification provided in the DPRs, expenditure incurred was ₹96.12 lakh (434 *per cent* increase) and ₹37.67 lakh (160 *per cent* increase) respectively.

- SIFL supplies different types of gears and pinions in a ready to fit condition that involved the process of forging and extensive machining. The Company did forging works in its forging unit at Athani and machining works through outsourcing at faraway places like Bangalore and Bhopal involving approximately 50 *per cent* of the total cost of the finished product. The objective behind setting up the Machining unit at Shoranur was to carry out all machining jobs in-house with better monitoring, control and with faster results.

  One of the machining works, gear hobbing process involves gear hobbing, gear shaping, gear grinding, heat treatment and inspection. This requires operation of the gear hobbing machine in tandem with gear grinding machine, gear shaping machine and co-ordinate measuring machine. DPR envisaged procurement of all these machines at a cost of ₹6.55 crore. SIFL, however, procured gear hobbing machine only excluding the remaining equipment needed for finishing operations due to non-availability of sufficient funds as discussed *in Paragraph 3.1.6*. As a result, the gear hobbing machine procured (March 2012) at a cost of ₹1.68 crore was not put to use so far (March 2015). Consequently, SIFL had to continue outsourcing these works. Moreover, due to failure of the Company to procure related equipment needed for finishing operations, against envisaged conversion of 4000 MT forgings for the first four years (2011-12 to 2014-15) actual conversion was only 811.07 MT forgings.

Gear hobbing machine lying idle at Machining Unit of SIFL at Shoranur

While accepting Audit observations, Management stated that efforts were being taken to utilise the gear hobbing machine after exploring the possibility of outsourcing balancing work.

- Similarly, though the DPR did not envisage procurement of shot blasting machine, SIFL procured the machine at a cost of ₹0.18 crore at the behest of Senior Manager (Special Projects) and was commissioned in March 2011. SIFL discontinued shot blasting and fettling operation and the machine was lying idle since May 2012.

  The Management replied (May 2015) that shot blasting process was adversely affecting the performance of the sophisticated co-machines and consequently, shot blasting and fettling operation at the Shoranur unit were discontinued. This indicates deficient procurement planning as the problems of shot blasting machines were known to the Company as they were using the same for their forging operations in its parent unit.

- DPR of Tool Room cum Training Centre of SIDCO and KELTRON envisaged giving short term training courses to 5400 students and 9060 students respectively up to March 2015 whereas actual training (long-term) was given to only 53 students and 391 students, respectively. SIDCO replied that their main aim was to focus on post diploma course for engineering graduate/ diploma holders and efforts were being made to provide awareness about courses to prospective students. However, the DPR envisaged short term training courses only and this deviation from DPR indicated that the same was not realistic and prepared arbitrarily. Basis for projection of short term training courses was not furnished to Audit, though called for.

- DPR of Tool Room cum Training Centre of SIDCO envisaged setting up of Effluent Treatment Plant (ETP) and obtaining approval from Pollution Control Board (PCB). Neither ETP was set up nor approval from PCB obtained, so far (February 2015).

  Company stated that ETP was not installed as the machine installed has in-built system to treat effluents.

  The reply was not acceptable since installation of in-built system to treat effluents was not informed to the PCB and certificate to that effect obtained from PCB. In the absence of certificate from PCB, adequacy of in-built ETP to treat effluent could not be ensured.

Non-availing of assistance under Government of India scheme

3.1.8 In XI Five Year Plan, GoI introduced a scheme for providing assistance to set up Mini Tool Room & Training Centre. As per the Scheme, GoI would provide one time grant equal to 90 *per cent* of the cost of machinery and equipment subject to a maximum of ₹9 crore.

The Tool Rooms cum Training Centre projects implemented by SIDCO and KELTRON were eligible for financial assistance under the above scheme. DPR of KELTRON also envisaged use of such grant. The total investment in these projects of SIDCO and KELTRON amounted to ₹7 crore and ₹3.25 crore respectively and the eligible grant on this investment was ₹9.23 crore[6].

The implementing agencies, however, did not tap GoI assistance due to misconception about the parameters by the unit-in-charge (AGM/IT) in case of SIDCO and purely an omission in case of KELTRON. Consequently, this fund gap had to be met through loans from MCL and GoK carrying interest rate of seven *per cent* and 11.5 *per cent* respectively resulting in avoidable interest burden of ₹3.22 crore[7] up to March 2015.

KELTRON stated (October 2015) that central assistance to set up mini tool room was eligible only for units set up under Public Private Partnership model.

The reply was not correct since State agencies were also eligible for central assistance according to the guidelines of the scheme.

SIDCO replied (June 2015) that earnest efforts were made to avail grant from GoI, but could not get the desired results as minimum two acres of land was lacking. The reply further stated that efforts were still being made to avail of the grant from GoI. The fact, however, remains that even though infrastructure

[6] **90 *per cent* of ₹7 crore and ₹3.25 crore.**
[7] **(₹4 crore*7 *per cent**4.5 years)+(₹2 crore *11.5 *per cent**4.5 years) +(₹2.93 crore *7 *per cent**4.5 years).**

facilities were created in February / March 2012, applications for the grants were yet to be submitted. In the case of SIDCO, the Company was ill-informed about the parameter of two acres of land, which was not taken care of in the guidelines issued for the scheme.

Irregularities in award of work

3.1.9 As per Kerala Financial Code (Rules 51 and 126), contracts for the supply of stores or the execution of works should be entered into after invitation of open tenders whenever the estimated value of contract exceeded ₹10,000. In all cases of open tender, wide publicity should be given to the tender notification. The codal provisions were not complied in the following two cases.

- Work Order (WO) for construction of factory building, substation building, etc., of House Wiring Cables Unit of TRACO was awarded (December 2010) to Kerala Electrical and Allied Engineering Company Limited (KEL) for ₹1.87 crore without inviting tender. In the absence of open tender, the competitiveness of rates could not be ensured and financial impact could not be ascertained.

  TRACO stated (October 2015) that work was awarded to KEL without invitation of tender since tendering process was time consuming and as per orders of Government, the project was due for completion within December 2010.

  The reply was not acceptable because tendering process was not to be compromised for timely completion of work and required additional time should have been sought from Government.

- In the award of civil works for Tool Room cum Training Centre of SIDCO, the implementing agency had failed to ensure competiveness of rates by giving wide publicity for the tender notification. Against publication of tender notice in one or more leading regional languages and one or more issues of a leading English newspaper as per provisions of Kerala Financial Code, tender advertisement was published only in local newspaper denying opportunity at all India level.

  SIDCO replied that the tenders for construction of civil works were advertised in local newspaper with the intension to curtail expenditure. The reply was not acceptable as the practice adopted by the agency was in violation of the codal provisions, which aimed at ensuring transparency and competitiveness of rates.

Unfruitful expenditure on recruitment

3.1.10 Industries Department, GoK created (January 2011) 395 posts as per the man-power requirement envisaged in the DPR of greenfield project and outsourced the recruitment to Kerala State Productivity Council, National Institute of Personnel Management and KITCO Placement Park. The agencies commenced (January 2011) the process of recruitment that was targeted to be completed by February 2011. The PSUs paid ₹0.41 crore as remuneration to these agencies. The conditions of recruitment included weightage to local candidates. The prospective candidates challenged the fairness of the recruitment process in the Honóble High Court of Kerala questioning the conditions in the notification for recruitment and the process of selection.

Accepting their contentions, the Honóble High Court stayed (February 2011) the selection process. In the meantime, 10 personnel were recruited for the greenfield projects. Based on this, GoK cancelled (December 2011) the remaining rank list already prepared and RIAB[8] has been appointed to oversee the recruitment process to ensure transparency. The new recruitment process was in progress. Thus, fee of ₹ 0.41 crore paid to the recruiting agencies became unfruitful. In the absence of recruitment, contract employees, apprentices and employees on deputation were engaged for the working of the greenfield projects thus, impacting the implementation period and commissioning schedule of the projects.

SIFL and KELTRON replied (May 2015) that they were not in a position to conclude the recruitment outsourced, consequent to the stay from Honóble High Court of Kerala. The reply was not acceptable since lack of transparency in the recruitment process was the root cause for Courtô intervention.

Hasty inauguration of the greenfield projects

3.1.11 As per Rule 4 and 5 of Kerala Factories Rules, manufacturing process shall be carried out only after obtaining Factory Licence. Due to delay in completion of construction, commissioning of machinery, obtaining statutory licences and electricity connections, the above projects were not in a position to commence the operations by the target date of December 2010. Despite this, inauguration ceremonies were conducted in January and February 2011 by incurring ₹0.48 crore by taking several *ad hoc* measures, like hiring generator instead of getting permanent power connection from Kerala State Electricity Board Limited (KSEBL)[9], to give a semblance of completion.

Mini Tool Room cum training centre of KELTRON commenced training (July 2012) and commercial production (February 2013) without obtaining Factory Licence from the Director of Factories and Boilers.

Further, both the Tool Room cum Training Centres of KELTRON and SIDCO had not obtained licence for fire and safety so far (March 2015) from the Department of Fire and Safety.

KELTRON replied (May 2015) that necessary steps were taken for obtaining fire and safety clearance. Further, necessary procedures had been completed for obtaining Factory Licence. Receipt of both the certificates was, however, awaited (December 2015).

[8] **Public Sector Restructuring and Internal Audit Board.**
[9] **Erstwhile Kerala State Electricity Board.**

Infructuous expenditure due to non-implementation of LCD Meter factory of UEIL

3.1.12 UEIL was awarded an order for six lakh LCD Meters by KSEBL with a delivery schedule of one lakh meters *per* month. Since Kollam unit had limitation to manufacture one lakh meters monthly, UEIL decided to set up a new production unit (LCD Meter Production Unit) at Palakkad under the greenfield project of GoK during 2009-10. DPR of the project envisaged supply of meters to other State power utilities as well. Kannadi Grama Panchayat allotted one acre of land for 99 years on lease basis to construct the proposed factory. The approved project cost of ₹5 crore consisted of construction of building worth ₹2 crore and procurement of machinery and other assets worth ₹3 crore. MCL advanced ₹5 crore for implementation of the project.

UEIL awarded the construction work to BSNL. They could not execute the construction work as the land allotted was unsuitable for construction and there was no approach road to the plot. Yet, UEIL made temporary arrangements at the Panchayat Community Hall at Kannadi Grama Panchayat, incurring total expenditure of ₹0.62 crore (including ₹0.20 crore towards cost of machinery) and inaugurated (January 2011) the project. Further, ₹0.38 crore was diverted for meeting the working capital requirements of another unit which was irregular.

After inauguration, UEIL decided (March 2011) not to go ahead with the project as KSEBL had stopped accepting meters from UEIL due to problems in the field performance of meters already supplied from Kollam unit (2.7 lakh LCD Meters). UEIL had not received any orders from other State electricity utilities even though the DPR had envisaged it. Thereafter, as ordered by GoK, balance fund of ₹4 crore was refunded (March 2011) to MCL.

Thus, selection of the project without proper feasibility study/ market potential resulted in infructuous expenditure of ₹0.62 crore.

UEIL replied (May 2015) that KSEBL stopped purchase of LCD Meter from them and hence, the LCD Meter Factory, Palakkad was not commissioned and machinery were not installed.

The reply of UEIL was not acceptable as cancellation of order by KSEBL was due to quality issues. Also, though the DPR envisaged orders from power utilities of other States, no such order could fructify.

Non-availing credit for excise duty paid on capital goods

3.1.13 As per Rule 3 and 4 of the CENVAT Credit Rules, 2004, a manufacturer or producer of final products was allowed to take credit (availment) of excise duty paid on capital goods received in the factory of manufacturer of final product. The CENVAT credit can be utilised for payment of excise duty on any final product. For availing the CENVAT credit, the assessee has to file return in which credit taken on capital goods on invoices issued by manufacturers has to be furnished. KELTRON procured (February to June 2011) machinery worth ₹2.91 crore (basic cost) paying ₹0.22 crore as excise duty but did not avail of the CENVAT credit (till March 2015) due to non-filing of return showing the details of capital goods purchased.

Management replied (May 2015) that CENVAT credit on machinery purchased would be availed during the financial year 2015-16. The fact, however, remains that even after a lapse of 39 months after commissioning the unit the CENVAT credit was not availed.

Conclusion

The implementation of the greenfield projects was beset with poor planning and execution of projects. The DPRs were prepared without actual feasibility study. Despite poor track record of TRACO, SIDCO and KELTRON, the decision of GoK to divert funds from MCL resulted in high probability of the loans advanced by MCL remaining irrecoverable. There were failures to avail of Central Government assistance and CENVAT credit. Envisaged funding was also not ensured leading to curtailment of investment in machinery and equipment. All these factors led to the greenfield projects clocking losses of ₹11.59 crore in their operations up to March 2014.

The matter was reported (October 2015) to Government; their reply was awaited (October 2015).

3.2 Material procurement in Kerala Agro Machinery Corporation Limited

Introduction

3.2.1 Kerala Agro Machinery Corporation Limited (Company) was established in March 1973 with the main objective of production, assembling and marketing of agricultural implements such as power tillers, reapers and tractors. The Company has four production units at Athani and Kalamassery (Ernakulam), Kanjikode (Palakkad) and Mala (Thrissur) with an aggregate installed capacity of 6000 power tillers. The Company did not assess installed capacity of other products namely, reapers and tractors.

The Company has been enjoying goodwill and brand image in the Indian tiller market especially in the North Eastern States. Over the years, the Company has developed a good dealer network. The turnover of the Company was generally showing an increasing trend which was mainly because of the product quality, goodwill as well as support from Government by way of subsidy. Despite enjoying goodwill and brand image, profit from operation of the Company was meagre, ranging from 1.23 *per cent* (2014-15) to 4.98 *per cent* (2010-11) of sales during 2010-11 to 2014-15. Since the material cost ratio showed wide fluctuation ranging from 67.88 *per cent* to 82.24 *per cent,* Audit reviewed practice of procurement of spares by the Company with reference to the provisions of Stores Purchase Manual (SPM) of Government of Kerala during the period 2010-11 to 2014-15.

Audit Findings

3.2.2 The Company followed an approved purchase procedure prepared for the purpose of ISO certification. The present system of procurement of raw material followed by the Company did not comply with the provisions of SPM and guidelines of Central Vigilance Commission (CVC). The procurement rules followed by the Company were also not approved by Government of Kerala (GoK). The non-compliance of procurement rules resulted in uneconomic and irregular procurement of material as discussed below.

Deficient vendor performance rating system

3.2.3 For production of agricultural implements, the Company requires 1914 different categories of spares. At the commencement of every financial year, the Company assesses the material required for all the four units and places annual purchase orders (PO) with the existing limited number of suppliers at the rate at which they were previously supplying the material.

The quantity to be supplied by each supplier was fixed not based on the economy of rates but in proportion to the weightage obtained in the vendor performance rating. Vendor performance rating system was made by giving weightage of 15 *per cent*, 35 *per cent*, 25 *per cent* and 25 *per cent* to four factors namely cost, timely supply, Inspection Goods Received Report (IGRR) acceptance[10] and assembly acceptance[11] respectively during the previous year.

The system of vendor performance rating was deficient as explained below.

- Performance evaluation was done on the basis of performance during the first nine months instead of preceding twelve months resulting in omission of performance during January to March every year. Audit analysed delivery performance of six spares during January to March of four years ended 2013-14 and noticed that there was non-delivery ranging up to 38 *per cent* of scheduled quantity. The Company procured the non-delivered quantity from other existing suppliers at their supply rate, through PO amendments resulting in extra expenditure as mentioned in *Paragraph 3.2.12*; and

- Lesser weightage (15 *per cent*) was assigned to cost factor and higher weightage was assigned to other factors (timely supply, IGRR acceptance and assembly acceptance) which should have otherwise been taken care of by incorporating penal clauses in purchase agreements. In spite of assigning higher weightage for timely supply

[10] **Percentage of material accepted to the material supplied.**
[11] **Percentage of material successfully processed in assembly section.**

and material acceptance, the instances of delayed/ short delivery and material rejection were on higher side.

The irregular methodology adopted for the vendor performance system made it improper and ineffective. Hence major procurement decisions, including issue of purchase orders, taken based on the system was found to be wrong.

The Company replied (September 2015) that since the annual purchase plan had to be completed by January, the performance of suppliers during January to March was not considered. It was also stated that since the practice was applicable for all suppliers alike, this would have no impact on evaluation. It was stated (November 2015) that the feasibility of including 12 months performance from January to December was under consideration of the management.

The reply was not acceptable since higher weightage (35 *per cent*) was given for timely supply of material and non-consideration of performance during January to March makes the vendor-performance rating system self-defeating.

Registration of new vendors

3.2.4 As per SPM, efforts should be taken to identify higher number of approved suppliers to obtain more eligible bids on competitive basis. As per clause 4.1.9 of the Quality System Procedure of the Company, the approved vendor list was to be updated once a year.

On scrutiny of the new vendors enlistment procedure, Audit noticed that the purchase department had not made efforts to widen the vendor base. Audit noticed that financial capability, previous experience, production capacity, etc., were not verified at the time of empanelment of new vendors. Audit noticed that 112 new suppliers were added to the vendor list during the period 2011-12 to 2014-15. The number of suppliers in the vendor list during 2010-11 was 229 and it was 239 during 2014-15, which showed a net increase of 10 suppliers. This showed that the performance of the Company in widening the vendor list was not effective. Further, the Company was not updating its vendor list annually.

Planning for procurement

Purchase procedure violating the provisions of SPM

3.2.5 As per the guidelines of CVC, the cardinal principal of any public purchase is to procure the material/ services of the specified quality at the most competitive prices and in a fair, just and transparent manner. To achieve this end, there should be a codified purchase manual containing the detailed purchase procedure, guidelines and also proper delegation of power so that there is a systematic and uniform approach in decision making. It is pertinent to mention that the GoK has made the provisions of SPM mandatory for all the PSUs in the State in respect of their operations/ procurement, etc.

Scrutiny of records revealed that the Company followed an approved purchase procedure prepared for the purpose of ISO certification. However, the procedures were inconsistent with the provisions of SPM. Absence of a purchase manual in line with provisions of SPM led to unrealistic assessment of requirement and extra expenditure as discussed in succeeding paragraphs.

The Company replied (September 2015) that it did not follow the provisions of SPM for procurement from the very inception. It was also stated (November 2015) that the Company being an ISO certified company followed purchase procedures as per ISO Manual.

The reply was not acceptable in view of the fact that compliance to provisions of SPM was mandatory for all PSUs in the State. The ISO manual followed by the Company was not at par or in conformity with the mandatory provisions of SPM.

Unrealistic assessment of requirement

3.2.6 As per Rule 6.1 of SPM, purchasing authority has to estimate material requirements for a year so far as can be foreseen. At the end of each financial year, each department should realistically assess its requirements of stores and equipment required during the next financial year based on the consumption during the previous three to five years and with reference to factors, if any, which justify an increase or decrease compared with the average.

The Company assessed material requirement based on budgeted production. The budgeted production/sales was decided on the basis of sales estimated by the marketing department. The management was unable to justify the estimates of the marketing department and hence, it was arbitrary.

- A comparison of the budgeted production of tillers with the budgeted production as per SPM as well as the actual production was made as shown below.

Table 3.3: Budgeted production *vis-à-vis* actual production of tillers

(No of tillers)

Year	Budgeted production		Actual production
	As done by Company	As per SPM	
2010-11	15000	9705	12182
2011-12	24000	10884	13478
2012-13	21000	12161	12085
2013-14	16000	12582	14577
2014-15	16500	13380	11825

Production budget to be prepared as per the provisions of SPM, based on three years average was in the range of 9705 to 13,380 tillers. The Company, however, budgeted production in the range of 15,000 to 24,000 tillers during the period 2010-11 to 2014-15 without any justifiable reasons for such increase.

Planning for procurement of raw material based on such inflated production budget resulted in wrong estimation of material requirement and consequent excess procurement of material leading to blocking up of funds and loss of interest of ₹2.44 crore as discussed below.

- Evaluation of stock accumulation of tiller spares during the period from 2010-11 to 2014-15 revealed that in respect of 714 spares, the inventory was held to meet the requirement for periods ranging up to 2373 daysô consumption. The Company was following the practice of issuing purchase orders for one year with monthly schedule of supply. Keeping 30 daysô consumption as optimum stock level, the excess inventory holdings resulted in blocking up of ₹ 25.42 crore and consequent interest loss of ₹2.03 crore.

  The Company replied (November 2015) that the material procurement was done based on actual requirement and there was no excess inventory due to suitable rescheduling of purchase orders.

  The reply was not acceptable as the inventory holding for periods up to 2373 days was noticed even after rescheduling of purchase orders.

- While there was a restriction imposed (April 2011) on the Company by the Honǿble High Court of Kerala for the recruitment to the newly established tractor unit, it imported (February/July 2012) 180 sets of components for manufacture of tractors at landed cost of ₹2.63 crore. Due to insufficient work force, only nominal production commenced (March 2013) through re-deployment of personnel from its Athani Unit and only 125 sets could be consumed until March 2015. The failure of the management in considering the factors for estimating the material requirement resulted in accumulation of stock up to three years and loss of interest ₹0. 41 crore.

  The Company replied (November 2015) that tractor components were procured in anticipation of starting commercial production of tractor unit, but recruitment for the Unit could not be done due to factors beyond its control and hence, production could not be carried out as anticipated.

  The reply was not acceptable since the Company had imported the components for production though restrictions on recruitment for the Unit were already in place.

Procurement of material

3.2.7 Public procurement activities should be conducted in a transparent manner ensuring competition, fairness and elimination of arbitrariness in the system. All public procurement should be made to ensure the lowest reasonable price for the material. Such a system was, however, absent in the Company as discussed below.

Procurement of material without tendering

3.2.8 As per Rule 7.7 of the SPM, system of open tender should be adopted for all purchases above ₹10 lakh and limited tender for value of purchases between ₹1 lakh and ₹10 lakh. Further, for purchase value between ₹0.15 lakh and ₹1 lakh, the system of issuing quotation enquiries should be adopted.

The Company never followed the practice of tendering as required by SPM for procurement of spares. During the period from 2010-11 to 2014-15, the Company issued 4113 POs for procurement of 1914 type of spares valuing ₹813.06 crore. All these POs were issued without inviting tenders or quotations enquiries as shown below.

Table 3.4: Details of procurement

Value of PO	Procurement procedure prescribed in SPM	No. of POs issued	Amount involved (₹ in crore)	Practice followed by the Company
Up to ₹15000	No Quotation	398	0.23	No Quotation
Between ₹15000 and ₹1 lakh	Through Quotation	715	3.62	
Between ₹1 lakh and ₹10 lakh	Limited Tender	1547	62.99	No Tendering
Above ₹10 lakh	Open Tender	1453	746.22	
Total		**4113**	**813.06**	

Thus, all the 3715[12] POs, which were to be issued based on tendering/quotation enquires were issued amongst the existing single suppliers/limited suppliers at the latest supply price. Audit noticed that spares worth ₹266 crore were procured from 19 suppliers during the review period. The major suppliers benefitted by the irregular procurement were Sree Ganesh Gears Private Limited, Autokast Limited, CVM Precisions Products Private Limited, Tolins Tyres Private Limited and Fairfield Atlas Limited. Moreover, Sree Ganesh Gears Private Limited was the major supplier who supplied 31 different categories of spares to the Company.

By resorting to procurement from limited number of suppliers when alternative suppliers were available in the market, the Company ignored the basic requirement of procurement *i.e.* ensuring competitive rate.

The Company replied (September 2015) that majority of the spares were specially designed components, the design of which cannot be disclosed to all, as the designs would be misused by spurious spare manufacturers**.** The reply was not acceptable since the Company had already implemented methods like affixing of hologram on the spares to prevent spurious spares designed by the

[12]Total No. of POs (4113) less No. of POs valuing up to ₹15000 (398).

Company. Further, the Company did not resort to competitive bidding even amongst the empanelled vendors who were given the design of spares.

Procurement at non-lowest rate resulting in extra expenditure

3.2.9 The Company, while issuing annual POs, did not consider the lowest rate at which materials were being supplied by the suppliers. Instead of giving preference to the lowest rate, requirement of annual quantity was divided among all the existing suppliers based on vendor performance rating. Further, in the event of short supply by any supplier, the non-delivered quantity was procured from other existing suppliers at higher rates.

Audit made a detailed analysis of difference in the procurement rates of each material and found that material were procured through annual POs, from different suppliers at different rates. During the review period, avoidable expenditure of ₹43.89 crore was incurred due to procurement of material at rates higher than the lowest rates, as detailed below:

Table 3.5: Procurement of material at rates higher than the lowest rate

Year	Total No. of POs verified	No. of POs in which purchases made from non-lowest suppliers	Total purchase value (₹ in crore)	Purchase value at lowest rate (₹ in crore)	Extra expenditure (₹ in crore)
2010-11	874	574	122.06	111.73	10.33
2011-12	765	601	148.72	135.56	13.16
2012-13	760	541	132.75	124.30	8.45
2013-14	748	463	151.12	143.62	7.50
2014-15	688	487	110.41	105.96	4.45
Total	**3835**	**2666**	**665.06**	**621.17**	**43.89**

The failure of the Management in ensuring the strict compliance to SPM in the procurement activity resulted in extra expenditure, which was avoidable, calling for fixing responsibilities.

The Company replied (November 2015) that suppliers with lowest rates were always given maximum quantity as per their capacity to supply and the balance alone was procured from others.

The reply was factually incorrect since POs were placed on the basis of vendor performance rating, which did not consider the capacity of suppliers. Moreover, the Company never verified the capacity of the suppliers at any stages of procurement.

In the Exit Conference held in January 2016, Government directed the Company to negotiate with suppliers to reduce the rate offered by them.

Procurement of material from single source

3.2.10 As per Rule 7.20 of the SPM, purchase through private placements, i.e. by issuing single tender enquiry to a selected source should be resorted to only in unavoidable situations like small order which does not exceed ₹10,000 and when articles purchased are of a proprietary character.

Scrutiny of records revealed that out of 1914 spares required by the Company, 559 non-proprietary spares (29.21 *per cent*) worth ₹179.35 crore were procured from single source through private placement during the period from 2010-11 to 2014-15. The major beneficiaries of such single supply who got the advantages of non-competitive monopoly pricing are as indicated in the following *Table*:

Table 3.6: Major beneficiaries of single supply

Supplier	Spare	Period of single supply	Amount (₹ in crore)
Bombay Forgings Private Limited	Crank shaft	2012-13 and 2013-14	3.34
K.L.N. Eng. Products Private Limited	Air cleaner assembly	2010-11 to 2014-15	3.12
Tolins Tyres Private Limited.	Tyre 6.00 x 12	2014-15	3.12
La-cast Metals & Comp Private Limited	Piston	2010-11 to 2013-14	2.94
Falcon Tyres	Tyre 18x7-8	2010-11 to 2013-14	2.05
Amar Metering Pumps	Oil Pump Assembly	2010-11 to 2013-14	1.51

In spite of availability of alternative suppliers in the market, the Company allowed many of the suppliers to continue to be single source during 2010-11 to 2014-15, affecting competitiveness of the procurement price as well as the transparency of the whole system of procurement in the Company.

The Company replied (September 2015) that the procurement was done from single source due to its proprietary nature. The Company further replied (November 2015) that alternative suppliers for a few spares could not be identified because of heavy prices demanded by them. The reply was factually incorrect as all the 559 spares were non-proprietary items and the Company failed to take initiative for identifying alternative suppliers in respect of single source supplies. The matter being serious, this requires investigation by the Government to set right the things in the Company.

Procurement of material without ensuring reasonableness of rates

3.2.11 As per Rule 9.46 of the SPM, before placing POs reasonableness of rates is to be ensured. The reasonableness of rates is to be judged (Rule 9.47) based on current market price of similar stores, cost of raw material used for production of the stores, etc.

In order to assess the reasonableness of the price, Audit assessed periodical upward revision in the prices of spares taking 2009-10 as base year. The increases in actual prices of spares were compared with the increases in Wholesale Price Indices (WPI)[13] of the particular spare/base material for producing the spare. Increase in the WPI of base material represents increase in the cost of material as well as its conversion cost. Hence, the increase in the price of a spare will normally be at par with the increase in the WPI of the particular spare/base material. Out of 85 high value category spares used for producing tillers, the rates of 53 spares were analysed. Of these, Audit noticed that prices of only 10 spares were reasonable and that of the remaining 43 spares procured from 125 suppliers were unreasonably high. The excess rate paid over the reasonable rate ranged up to 50.72 *per cent*. The reasonable price of these 43 spares worked out by the Audit using WPI was ₹170.62 crore whereas the amount paid by the Company on the procurement of these spares was ₹185.93 crore which resulted in extra expenditure of ₹15.31 crore (approximate) during the period from 2010-11 to 2014-15, as detailed below.

Table 3.7: Procurement of spares at unreasonably high prices

Base Material	**No. of spares**	**Reasonable price worked out based on WPI (₹in crore)**	**Actual expenditure incurred on purchase (₹in crore)**	**Extra expenditure (₹in crore)**
Cast Iron	20	70.88	79.97	9.09
Aluminium Castings	3	4.24	5.61	1.37
Aluminium Alloy	1	6.06	6.16	0.10
Steel Rod	2	14.01	16.07	2.06
Steel	1	4.27	4.76	0.49
Gear	14	45.45	47.27	1.82
Tyre	1	21.32	21.62	0.30
Crank Shaft	1	4.39	4.47	0.08
Total	**43**	**170.62**	**185.93**	**15.31**

There was no system to ensure the reasonableness of the procurement price through a systematic and dynamic market analysis by the Materials Department, in addition to competitive bidding. The Company disregarded the provisions of SPM and continued to follow the prevailing system of purchase of its own having no authority or approval of the Government resulting in procurement of spares at unreasonably higher rate. The top management of the Company failed to form a policy for ensuring compliance with SPM provisions. Besides, the Head of the Material Department did not bring the lapse to the notice of Companyøs management. Details of major suppliers who got undue advantage of procurement at above the prevailing market rate during the review period are given in *Table 3.8*:

[13] **The WPI published monthly by the Economic Adviser, Ministry of Commerce and Industry, Government of India is a reliable indicator of price of industrial material prevailing in the wholesale market in the country.**

Table 3.8: Major suppliers who got undue advantage of procurement at above the prevailing market rate

Sl. No.	Supplier	Spare	Base Material	Purchase Value (₹ in crore)
1	Willmac Engineering India Private Limited	Blade Shaft	Steel Rod	5.24
2	Industrial Aids	Fly Wheel	Cast Iron	3.97
3	Saroj Foundaries	Cylinder Head	Cast Iron	2.64
4	Turntech Engineers	Blade Shaft	Steel Rod	2.56
5	FL Arya	Fly Wheel	Cast Iron	2.55
6	Shri Ganesh Foundry Private Limited	Cylinder Head	Cast Iron	2.36
7	Rugmini Engineering Industries	Blade Shaft	Steel Rod	2.27
8	Rugmini Engineering Industries	Cylinder Head	Cast Iron	1.51
9	Enkey Precision Industries	Auxiliary Wheel Hub	Aluminium castings	1.06
10	Ashwin Engineering	Blade Shaft	Steel Rod	0.45

The Company replied (November 2015) that reasonableness of the rates quoted was always ensured by collecting break up of rates quoted and rates of base material were also compared with the price index of material.

The reply was factually incorrect as the Company did not make a comparison of rates of base material with the price index of material nor did it produce evidence for the same to Audit.

Contract Management

Modifications of terms and conditions in purchase orders

3.2.12 As per Rule 14.6 of SPM, any amendment to contract terms requested by the suppliers having financial impact should be made only after ensuring that the amendment will not have any adverse effect on the financial interest of the Company. Further, as per the terms of the PO, the Company was not bound to allow price variation.

Based on recommendations of purchase committee, the Managing Director frequently amended the POs in favour of 163 suppliers (67 *per cent*) out of 245 suppliers by increasing the price as demanded by them. This was done without assessing the financial impact on the Company or reasonableness of the prices but based on purchase bills submitted by the suppliers. The failure of the Head of the Material Department in complying with the provisions of SPM resulted in extra expenditure to the Company. The undue favour extended to various suppliers by amending POs worked out to ₹18.34 crore as given in *Table 3.9*:

Table 3.9: Amendment of purchase orders.

Year	Total number of suppliers	Number of suppliers benefited due to PO amendment	Extra expenditure (₹in crore)
2010-11	229	172	6.36
2011-12	252	176	7.26
2012-13	256	161	2.49
2013-14	250	158	1.54
2014-15	239	148	0.69
Average/Total	**245**	**163**	**18.34**

Audit also noticed that the frequent amendments to quantity and rates of the original POs were made in the electronic data base by retaining the same PO number and date. Hence, the authenticity of the numerous and frequent amendments could not be verified in the absence of the amendment history in the software. In order to ensure transparency and control over amendments, there should be a system to retain the original quantity and rate of the POs even after amending the same subsequently. Further analysis of irregular PO amendments revealed that the following suppliers were the major beneficiaries who got price revision repeatedly:

Table 3.10: Major beneficiaries who got price revision repeatedly

Supplier	Categories of spares procured (No.)	Instances of price revisions (No.)	Extra expenditure (₹ in crore)
Sree Ganesh Gears Private Limited	31	118	1.33
Autokast Limited	2	28	0.70
Auto Wings	20	44	0.55
Gear Systems	3	9	0.50
Falcon Tyres	4	10	0.49
Total			**3.57**

The Company replied (September 2015) that it followed the practice of amending the POs for a long time. The Company further replied (November 2015) that amendments were made to ensure uninterrupted supply of material and were done as per procedures followed by the Company.

The reply was not acceptable as practice is not a substitute for law/rules/SPM. Thus, non-compliance to rules resulted in extra expenditure of ₹18.34 crore. Thus, non-compliance with applicable rules by the Company's officials is a serious lapse for which their responsibility needs to be fixed.

Inter-State purchases without Government approval

3.2.13 SPM (Rule 9.31) provides that purchases exceeding ₹2.50 crore *per annum* from outside Kerala, when the same product is being manufactured by one or more units in the State, will be made only after approval by a

Committee consisting of the Chief Secretary, the Finance Secretary, the Secretary (Industries) and the Secretary of the Department concerned. The Company, however, procured five categories of spares viz., cylinder frame, flywheel, main clutch assembly, radiator and tyre 6x12 which are manufactured by one or more units in the State without obtaining approval from the above Committee. The value of spares procured during the period from 2010-11 to 2014-15 in contravention to the provisions of the SPM worked out to ₹36.41 crore.

The Company replied (September 2015) that preference was given to manufacturers in the State and no item available indigenously was purchased from outside the State. The reply was factually incorrect as the above referred five categories of spares were procured from outside the State despite availability of the material in the State[14].

Non-execution of agreements

3.2.14 As per Rule 9.60 of the SPM, an agreement should be entered into with the supplier for the satisfactory fulfilment of the contract embodying the conditions of the order and providing for necessary penal clauses for any breach of the conditions of the contract. The SPM also provides for obtaining performance security of five *per cent* for supply orders valuing more than ₹1 lakh and for claiming liquidated damages in case of delayed delivery.

The Company, however, did not execute agreements with suppliers. Though the POs contain a clause that the Company was at liberty to recover liquidated damages in case of loss incurred on account of delayed delivery, the rate at which the liquidated damages to be recovered was not mentioned in the POs due to which Management failed to recover liquidated damages from any of the defaulted suppliers during the review period.

Though 3000 POs were required to be covered under performance guarantee, none of the POs contained any clause on performance security. Hence, the Company failed to ensure contractual delivery of the spares. On a review of delivery against 372 POs, it was noticed that there were short delivery of ordered quantity in 243 POs.

The Company replied (November 2015) that it had to revise the POs or delivery schedules due to uncertainties in the market and hence, executing agreement incorporating the provisions for penalty or liquidated damage was not feasible. The reply was not acceptable since frequent revisions in the POs that were issued based on vendor performance rating system were contradictory to the very purpose of the system. Presently, the system does not play any role in ensuring timely and quality supply, but kills the competition *ab-initio*, making the procurement costlier. Non-compliance with

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[14] **Manufacturers of the five spares within Kerala are Autokast Limited, Alappuzha (Cylinder frame and Flywheel), Gayathri Enterprises, Palakkad (Main clutch assembly), Metal Land Industries, Ernakulam (Radiator) and Tolins Tyres Private Limited, Ernakulam (Tyre).**

the provisions of SPM on agreement and penal provisions on the ground of convenience was not justifiable.

Higher incidence of assembly rejections

3.2.15 When the spares entered into assembly line fail due to deviations in the specification, or defective design or poor quality, the material is rejected as assembly rejections. As per the provisions of the PO, ñé proportionate recovery as per norms for assembly rejection note would be effectedò. Assembly rejection of spares results in wastage of resources, time and consequent hike in the operating expenses of the Company. Hence, there should be a prudent system for locating as well as reducing the instances of assembly rejections. On a scrutiny of assembly rejections during the review period, the number of spares rejected from the assembly line increased from 2883 (2010-11) to 5409 (2014-15).The aggregate value of assembly rejections during the audit period was ₹4.48 crore.

On a detailed analysis of instances of the assembly rejections during the period from 2010-11 to 2014-15, it was noticed that out of total assembly rejection of material valuing ₹4.48 crore, material valuing ₹1.41 crore were supplied by six suppliers[15] (31.47 *per cent*).

All the assembly rejections were reflected in the vendor performance report of the suppliers concerned. As the weightage for the assembly rejection was 25 *per cent*, the overall performance was good due to higher score in other criteria. In cases of poor assembly rejection note score, the suppliers were not disqualified and continued to get POs based on their performance rating. Even the suppliers with poor performance rating could get higher quantity through frequent PO amendments. The higher incidence of assembly rejections showed that the present system of vendor performance rating giving weightage for assembly rejection is ineffective and favoured a few suppliers.

The Company (November 2015) replied that the limit fixed for assembly rejection was 0.5 *per cent* of the material input and the actual assembly rejections were slightly higher than the limit fixed. The reply was not tenable as the actual assembly rejections reached up to 152 *per cent* (2012-13) of the standard fixed.

Conclusions

The Company failed to ensure procurement of material at competitive rates by following mandatory provisions of SPM on competitive bidding. The Company also failed to assess the requirement of material through budgetary control. Board of Directors, which was to give proper direction and guidance for the operation of the Company also failed to ensure that the Company adopted mandatory provisions of SPM.

[15] **Austin Engineering Company Limited, Es Es Auto Engineerings, Autokast Limited, Manikam Radiators Private Limited , Auto Wings and R.K. Enterprises.**

Recommendations

Since there have been widespread deviation from the SPM and large quantity of items have been purchased from suppliers selected as indicated in the report without tender under the garb of ñsingle source supplierò, an in-depth investigation by the Vigilance Department may be ordered by the Government followed by fixing of responsibility.

The Company should evolve its own purchase manual/policy in conformity with the provisions of SPM. The Company should also take effective steps to widen its vendor base to minimise dependence on single/limited sources of supply. Competitive bidding should also be adopted to economise the procurement of material.

The matter was reported (October 2015) to Government; their reply was awaited (December 2015).

Compliance of Public Sector Undertakings to the provisions of Income Tax Act, 1961

Scrutiny of compliance of Public Sector Undertakings to the provisions of the Income Tax Act revealed instances of delay in submission of tax returns, non-payment of required amount of advance tax and consequent payment of interest, etc.

3.3 As per Section 28 of Income Tax Act, 1961(Act), profits or gains arising out of any business or profession carried out by companies shall be chargeable to income tax. Such companies shall have to file annual return of tax within 30 September of the assessment year[16] under Section 139 of the Act.

Public Sector Undertakings (PSUs) in the State carry on the business of manufacture, trading, financing activities, etc., and hence, are liable to pay tax on profits arising out of such business. A scrutiny of compliance of PSUs to the provisions of the Act was undertaken by Audit. Audit scrutiny revealed instances of avoidable expenditure on account of delay in submission of tax returns, non-payment of required amount of advance tax, etc., by eight[17] PSUs as discussed in succeeding paragraphs.

Avoidable payment of interest due to delay in submission of tax return

Section 139 of the Act requires a company to furnish tax return in the prescribed form on or before the due date i.e 30th day of September of the

[16] **Assessment year is the year immediately following the financial year (F.Y) wherein the income of the F.Y. is assessed.**

[17] **Kerala Transport Development Finance Corporation Limited, Kerala State Financial Enterprises Limited, Bekal Resorts Development Corporation Limited, Keltron Electro Ceramics Limited, Kerala State Beverages (Manufacturing & Marketing) Corporation Limited, Kerala State Maritime Development Corporation Limited, Kerala State Mineral Development Corporation Limited and Kerala State Civil Supplies Corporation Limited.**

assessment year. The tax returns are to be filed after completion of audit of accounts of the respective years (Section 139 (6)). As per Section 140(c), the return shall be verified by the Managing Director. In case of failure to file tax return on or before due date, interest is chargeable on the amount of tax at the rate of one *per cent per* month or part of the month for delay (Section 234 A of the Act).

Scrutiny of records revealed that in respect of five[18] PSUs, there were delays ranging from one month to eighteen months in filing tax returns of seven assessment years due to delay in finalisation and audit of accounts. As a result, these PSUs had to pay penal interest of ₹70.07 lakh under Section 234 A of the Act as tabulated in ***Appendix 8***.

Bekal Resorts Development Corporation Limited replied that they had not delayed the tax returns for the assessment year 2014-15.

The reply was incorrect since the Company had delayed filing of tax return for the assessment year 2014-15 by two months and paid interest of ₹0.54 lakh due to the delay.

Keltron Electro Ceramics Limited and its Administrative Department[19] replied that it could not file tax return on time due to its inability to pay tax.

The reply was not acceptable since payment of income tax is mandatory and was not dependent on availability of fund.

Kerala Transport Development Finance Corporation Limited, Kerala State Maritime Development Corporation Limited and Kerala State Mineral Development Corporation Limited replied that they could not file tax return on or before due date due to shortage of skilled and trained staff. Administrative Departments[20] of these three PSUs endorsed the views of the PSUs.

The replies are not acceptable since the companies could have hired skilled staff for filing tax return in time.

Avoidable payment of tax due to delay in submission of tax return of losses

As per Section 72 of the Act, loss under the head "Profits and gains of business or profession" could be carried forward[21] for eight years and set off against future profit. Such set off is admissible only if the return of loss of the year in which loss is incurred is furnished on or before the due date (Section 80 of the Act).

It was noticed that Kerala State Maritime Development Corporation Limited (KSMDCL) had incurred accumulated loss of ₹9.38 crore during the period

[18] Bekal Resorts Development Corporation Limited (2014-15), Keltron Electro Ceramics Limited (2013-14 and 2014-15), Kerala Transport Development Finance Corporation Limited (2012-13 and 2013-14), Kerala State Maritime Development Corporation Limited (2014-15) and Kerala State Mineral Development Corporation Limited (2011-12).

[19] Industries Department.

[20] Administrative Departments of Kerala Transport Development Finance Corporation Limited, Kerala State Maritime Development Corporation Limited and Kerala State Mineral Development Corporation Limited are Transport Department, Fisheries & Ports Department and Industries Department respectively.

[21] As per Section 72 of the Act, if loss of any business/ profession (other than speculative business) cannot be fully adjusted in the year in which it is incurred, then the unadjusted loss can be carried forward for making adjustment in the next years against income charged to tax under the head "Profits and gains of business or profession".

2004-05 to 2007-08 which was eligible for carry forward and set off against future profits up to the year 2015-16. KSMDCL did not, however, file tax return for the period 2004-05 to 2007-08 on or before due dates due to delay in finalisation and audit of accounts.

Audit scrutiny further revealed that during the two years 2012-13 and 2013-14, KSMDCL had earned aggregate taxable profit of ₹1.43[22] crore which was adjustable against loss of ₹9.38 crore incurred during the period 2004-05 to 2007-08. Since the tax returns for 2004-05 to 2007-08 were not filed on or before due dates, the benefits of set off could not be availed of and KSMDCL had to pay avoidable tax of ₹38.22 lakh[23].

KSMDCL stated (September 2015) that delay in filing of return was due to delay in finalisation of accounts.

The reply was not acceptable since KSMDCL had the option to appoint tax auditors for tax audit under Section 44 of the Act in case of delay in finalisation of accounts.

Avoidable payment of interest due to failure/ defaults in payment of advance tax

Section 208 of the Act stipulates that every company shall pay advance tax during the financial year when amount of tax payable exceeds ₹10,000. Failure to pay at least 90 *per cent* of the tax in advance by March attracts interest at the rate of one *per cent per* month or part of a month (Section 234B of the Act).

Scrutiny of records revealed that there was shortage in payment of advance tax by seven PSUs in respect of 14 Assessment Years as these PSUs could remit advance tax ranging from 1.06 *per cent* to 76.58 *per cent* only within stipulated dates while one PSU[24] did not remit any advance tax at all. As a result, these eight PSUs had to pay interest of ₹15.98 crore under Section 234B as tabulated in ***Appendix 9.***

Default in payment of required amount of advance tax was due to non-compliance with provisions of the Act on computation of advance tax by estimating current income after giving due consideration to last assessment, last return, tax deducted at source, etc.

Avoidable payment of interest due to non-payment of quarterly instalments of advance tax

Section 211 of the Act stipulates that advance tax has to be paid in instalments. Companies are to pay advance tax in a staggered manner in four quarterly instalments[25] between June and March of the corresponding financial year. If any instalment is not paid or less paid, interest is chargeable[26] for non-payment or late payment of such instalment. Audit noticed 17 instances where

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[22] ₹1.33 crore in Financial Year 2013-14 and ₹0.10 crore in Financial Year 2012-13.
[23] Including interest of ₹4.74 lakh paid under Sections 234A, 234B and 234C of the Act .
[24] Kerala State Maritime Development Corporation Limited.
[25] 15 *per cent* by 15th June, 45 *per cent* by 15th September, 75 *per cent* by 15th December and 100 *per cent* by 15th March.
[26] At the rate of one *per cent per* month (Section 234 C of the Act).

the companies could not pay the required advance tax in four instalments on or before due dates prescribed. The interest paid due to deferment of advance tax worked out to ₹6.49 crore as tabulated in ***Appendix 10***.

Kerala State Financial Enterprises Limited stated (August 2015) that the short payment was due to lack of availability of information from branches at the time of payment of advance tax which would be rectified by implementation of Core Solution Software connecting all branches.

The reply was not acceptable as a similar assurance was given by the Management in June 2012 when similar issue was brought to their notice, which was not acted upon.

Bekal Resorts Development Corporation Limited stated that a refund claim was pending with Income Tax Department and hence advance tax not paid. The fact, however, remains that Income Tax Department has not yet (September 2015) admitted the refund.

KSMDCL stated (October 2015) that payment of interest under Sections 234 B and 234 C was due to erroneous accounting of loss incurred out of the project executed for Port Department.

The reply was not acceptable since the error in accounting has resulted in avoidable expenditure of ₹4.12 lakh.

Kerala State Beverages (Manufacturing & Marketing) Corporation Limited stated that they could not estimate its tax liability accurately due to wide variation in monthly sales and hence, could not avoid interest under Sections 234 B and 234 C of the Act.

The reply was not acceptable as the Company could have paid the required amount of advance income tax by estimating tax liability approximately using the management information system existing in the Company thereby avoiding payment of interest under Sections 234 B and 234 C of the Act.

Kerala State Civil Supplies Corporation Limited replied that writing off of accumulated interest on Government loan was only a book adjustment in the account of the Company without any inflow of cash, which ultimately resulted in payment of tax. The Company also replied that interest paid for non-remittance of income tax was not much, compared to the interest paid on cash credit.

The reply was not acceptable since payment of income tax was mandatory and the Company could have taken into account the waiver of interest while paying income tax.

Avoidable payment of tax due to failure to deduct tax at source

As per Section 194 C of the Act, companies are required to deduct two *per cent* income tax at source from payments made to contractors for carrying out any contractual work. Tax so deducted shall be paid to the credit of Government on or before seven days from the end of the month in which the deduction is made and before 30th day of April in the case of deductions made in March (Rule 30 of Income Tax Rules, 1962). Non-compliance with the above provisions would render expenditure on the contract work inadmissible in computing the income chargeable under the head Profits and Gains of business or profession as per Section 40(a) (ia) of the Act.

It was noticed that Kerala State Mineral Development Corporation Limited had failed to deduct and remit tax on payment of ₹3.13 crore made to contractors in 2010-11 as a result of which the expenditure was disallowed from computing the taxable income of the PSU. Hence, the Company became liable to pay income tax of ₹1.02 crore, which was avoidable.

The Company replied that the problem occurred due to its inability to meet the tax liability on account of acute shortage of fund and lack of qualified or experienced accounting personnel to handle the payment of TDS on or before the due date.

The reply was not acceptable since payment of income tax is mandatory and was not dependent on availability of fund. Further, the Company could have hired qualified or experienced accounting personnel to handle the payment of TDS.

The matter was reported (October 2015) to Government; their reply in respect of four PSUs[27] is awaited (December 2015).

Though the Administrative Departments concerned were invited (October 2015) for discussing the matter, they did not respond.

Kerala State Coastal Area Development Corporation Limited

Avoidable payment of corporate tax

Erroneous accountal of interest earned on unutilised funds pertaining to Government projects resulted in avoidable payment of corporate tax amounting to ₹1.29 crore.

3.4 Kerala State Coastal Area Development Corporation Limited (Company) is engaged in planning, formulating and implementing various development projects and programmes for sustainable fisheries development in the State. For this purpose, the Company acts as the implementing agency for various development schemes financed by Central and State Governments. The Ministries/Departments/Agencies of Central and State Governments provide grants to the Company in advance. The Company also receives consultancy fee fixed by the Government(s) for implementing these projects.

According to Generally Accepted Accounting Principles and Conventions (GAAP), interest earned on unutilised grants pertaining to Government projects, shall not be treated as income of the Company unless the Government Orders/ agreements specifically provide that such income could

[27] **Kerala State Financial Enterprises Limited, Kerala State Civil Supplies Corporation Limited, Bekal Resorts Development Corporation Limited and Kerala State Beverages (Manufacturing & Marketing) Corporation Limited.**

be treated as income of the Company. As per the GAAP, interest earned on unspent balance should be added to the grant amount.

During the four years period ended 2012-13, the Company received ₹136.09 crore towards grants from Government of India and its agencies (₹69.89 crore) and Government of Kerala and its agencies (₹66.20 crore) for implementation of various schemes. The Company invested unspent balance of grants ranging from ₹6.57 crore (2009-10) to ₹39.29 crore (2012-13) in interest bearing bank deposits and earned interest of ₹5.77 crore. None of the Government Orders or Sanctioning Orders, according to which grants were sanctioned, specified that the Company could take interest earned on unspent balance as its income. As such, interest earned on unspent grants ought to have been added to the grant.

Scrutiny of records revealed that in violation of the above GAAP, the Company had accounted interest of ₹5.77 crore earned on unspent balance of grants as its own income in the accounts for the period 2009-10 to 2012-13. This resulted in inflating taxable income of the Company and consequent avoidable payment of corporate tax to the tune of ₹1.29 crore as shown below:

Table 3.11: Statement showing tax liability of the Company

(₹ in lakh)

Previous year	Assessment year	Interest income	When interest on unspent grant is included in its income		If interest on unspent grant is excluded from its income	
			Taxable income	Tax liability[28]	Taxable income	Tax liability
2009-10	2010-11	13.26	9.95	3.07	(-) 3.31	Nil
2010-11	2011-12	136.39	121.75	40.44	(-) 14.64	Nil
2011-12	2012-13	129.45	133.69	43.38	4.24	Nil[29]
2012-13	2013-14	297.43	128.77	41.78	(-) 168.66	Nil
Total		**576.53**		**128.67**		**Nil**

Thus, due to erroneous treatment of interest earned on unspent balance of grants as its own income, the Company had to pay corporate tax to the tune of ₹1.29 crore which was avoidable.

The overstatement of profit due to recognition of interest on term deposit made out of Government grants was included in CAGôs Comments on the Companyôs Annual Accounts for the year 2010-11 in the Supplementary Audit.

The Company stated (September 2015) that the funds received from Central Government agencies were kept as fixed deposits and interest accrued from

[28] **Excluding the interest paid due to non-compliance with the provisions of Income Tax Act, 1961.**

[29] **As per Section 80 of the Income Tax Act 1961, business losses can be carried forward for eight assessment years and set off against business income. Hence, business losses of ₹3.31 lakh and ₹14.64 lakh for the assessment years 2010-11 and 2011-12 respectively can be set off against the business income of ₹4.24 lakh for the assessment year 2012-13.**

such deposits was accounted for as the income of the Company in accordance with the requirement of Schedule VI of the Companies Act, 1956.

The reply of the Company is not acceptable since Schedule VI[30] does not specify that interest earned on the unspent balance of grant can be treated as income. Recognition of interest income was rather to be based on GAAP, which was violated in this case resulting in avoidable payment of corporate tax.

Government replied (November 2015) that the Company undertook consultancy works for National Fisheries Development Board, District Tourism Promotion Councils, etc., as an accredited agency and the funds received against these were parked in bank accounts and interest earned from such works treated as income of the Company.

The reply of Government is not acceptable since there was no specific direction in the sanction orders or Memorandum of Understanding (MoU) with the National Fisheries Development Board, etc., to treat interest income on unspent balance of grant funds towards implementation of various schemes as income of the Company. Moreover, according to the MoU between the Company and the National Fisheries Development Board, the Company was to open a separate current account to maintain receipts, grants, etc. As such, the grants received were not to be deposited in fixed deposits. Therefore, treating of interest earned on unspent balance of grants as its own income was erroneous. Besides, the audit objection pertains to grant funds and not money received for consultancy works by the Company.

Malabar Cements Limited

Avoidable extra expenditure

Non-collection of adequate security deposit (SD) to ensure due performance of the contract coupled with non-recovery of damages resulted in avoidable extra expenditure of ₹1.77 crore to the Company.

3.5 As per rule 8.17 of the Stores Purchase Manual of Government of Kerala, to ensure due performance of the contract, performance security is to be obtained from the successful bidder who is awarded the contract. Performance security is to be obtained from every successful bidder irrespective of its registration status, etc., for a contract value above ₹1 lakh. Performance security may be furnished in the form of an account payee demand draft, fixed deposit receipt from a commercial bank or bank guarantee from a commercial bank. The performance security should be equivalent to five *per cent* of the total value of the contract, rounded off to the nearest rupee.

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[30] **It specifies the form of Balance Sheet, requirements as to Profit and Loss Account, interpretation and Balance Sheet Abstract and Company's General Business Profile.**

Malabar Cements Limited (Company) is a fully owned Government company engaged in the manufacture of cement using limestone. The Company invited (December 2011) tenders for collection and transportation of up to 10,000 Metric Ton (MT) of limestone per month from Tamil Nadu Minerals Limited, Ariyalur to the Company. According to the tender conditions, the bidders were to quote rate for one MT of limestone and the maximum quantity that can be transported in a month. The Company reserved the right to place order on one or more firms at the lowest quoted (L1) rate.

NT Lorry Service (NTLS), the L1 bidder, offered to transport 6000 MT of limestone monthly at the rate of ₹433 per MT and accordingly, the Company placed (March 2012) the work order on them for monthly transportation of 6000 MT. For the balance 4000 MT of limestone, work order was placed (March 2012) on Radha Lime Stone (RLS) at the L1 rate of ₹433 per MT. The period of contracts was one year from 27 February 2012 to 26 February 2013.

As per terms and conditions of the contracts, NTLS and RLS remitted ₹5.60 lakh[31] as SD which would be forfeited in case of their failure to carry out the work. Further, the balance work would be executed through an alternative agency at the risk and cost of NTLS and RLS. They were also liable to pay liquidated damages at the rate of ₹10 *per* MT on the undelivered quantity.

Against the contracted transportation of 10,000 MT of limestone per month for one year, NTLS and RLS transported an aggregate 17221.30[32] MT of limestone only for five months up to May 2012 despite availability of limestone at site. The NTLS and RLS failed to transport the contracted quantity on the ground that the rates quoted were not favourable to them, as also due to delay on the part of the Company in unloading limestone at Companyȏs site. On this, the Company invited (May 2012) fresh tenders and engaged alternative agencies[33] for transportation of the balance quantity at the rate of ₹608 per MT. In the alternative contract, the Company incurred additional expenditure of ₹1.77 crore. Although the additional expenditure was recoverable from NTLS and RLS as per provisions of the contracts, this amount has not, however, been recovered as yet (April 2015).

Audit noticed (October 2014) that purchase policy of the Company, approved by the Board of Directors in April 2010, diluted and limited SD to five *per cent* of three monthsȏ value of the contract despite Stores Purchase Manual warranting collection of five *per cent* of the total value of contract as SD. Consequently, against ₹25.98 lakh[34] to be kept as SD as per the Stores Purchase Manual, the Company actually held SD of ₹5.60 lakh only. Thus, failure on the part of Company to collect adequate SD, led to non-performance of the contract by NTLS and RLS and the Company had to incur additional expenditure in the alternative contract. The Company has not recovered the risk and cost amount of ₹1.77 crore involved in the alternative contract from NTLS and RLS.

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[31] **₹3 lakh held as EMD from NTLS and ₹2.60 lakh remitted as SD by RLS.**
[32] **NTLS-1240.30 MT and RLS-15981 MT.**
[33] **Raja Warehouse and Logistics (8000 MT) and Vijayalakshmi Transport (2000 MT).**
[34] **120000 MT*₹433*5 *per cent.***

Thus, non-collection of adequate SD to ensure due performance of the contract coupled with non-recovery of damages resulted in avoidable extra expenditure of ₹1.77 crore to the Company.

The Company stated (April 2015) that they had filed (April 2015) a suit for recovery of damages against the defaulted firms. The reply of the Company was not acceptable since the Company had failed to ensure due performance of the contract through collection of SD as per the provisions of Stores Purchase Manual. Further, Company's legal action to recover damages was late by three years due to delay by Company's Legal Department and was initiated only after this being pointed out (October 2014) by Audit. The delay may compromise the Company's position in the Court of Law.

The matter was reported (June 2015) to Government; their reply was awaited (December 2015).

Though the Administrative Department was invited (October 2015) for discussing the matter, they did not respond.

Kerala State Civil Supplies Corporation Limited

Avoidable committed liability

The Company incurred avoidable additional liability of ₹0.40 crore due to inordinate delay in complying with provisions of the Companies Act, 1956.

3.6 Section 94 of the Companies Act 1956[35] (1956 Act) permitted a company to alter its share capital by passing a resolution in general meeting if so authorised by its Articles of Association (AoA). Section 97(1) of the 1956 Act further provided that if increase of share capital is beyond authorised share capital of the company, notice of such increase shall be filed with the Registrar of Companies (RoC) within 30 days after passing resolution in the general meeting. Application fee at the prescribed rate[36] for increase in share capital was also payable.

Kerala State Civil Supplies Corporation Limited (Company) is a wholly owned Government company with an authorised capital of ₹15 crore. AoA of the Company empowered its Board of Directors (BoD) to increase the share capital by passing an ordinary resolution[37] in the general meeting.

An increase in the authorised capital of the Company became necessary when Government of Kerala (GoK) converted (November 2009) the loan of ₹133.46 crore advanced to the Company into equity and the Company accounted the same as share capital advance. The BoD of the Company, thereafter, resolved

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[35] **Repealed by Companies Act 2013.**

[36] **₹4000 upto ₹1 lakh, ₹300 for every ₹10,000 increase after ₹1 lakh up to ₹5 lakh, ₹200 for every ₹10,000 increase after ₹5 lakh upto ₹50 lakh, ₹100 for every ₹10,000 increase after ₹50 lakh up to ₹1 crore and ₹50 for every ₹10,000 increase after ₹1 crore.**

[37] **An ordinary resolution is a resolution passed by the shareholders of a company by a simple or bare majority (for example more than 50 *per cent* of the vote) either at a convened meeting of shareholders or by circulating a resolution for signature.**

(September 2012) to increase its authorised share capital to ₹175 crore. BoD's decision was to be followed by passing an ordinary resolution in the general meeting and filing notice of increase with the RoC along with application fee of ₹0.80 crore[38].

Scrutiny of records, however, revealed that although the Company had held three general meetings[39] after the BoD's decision, no resolution was moved for increasing the authorised share capital. As a result, the notice for increase of authorised share capital could not be filed with the RoC so far (August 2015).

Meanwhile, Government of India enacted the Companies Act, 2013[40] and promulgated (March 2014) the Companies (Registration Offices and Fees) Rules, 2014. As per the Companies (Registration Offices and Fees) Rules, 2014, fee to be paid for enhancement of authorised share capital was increased[41] by ₹25 for every ₹10,000 increase in share capital beyond ₹1 crore. Accordingly, the Company became liable to pay fee of ₹1.20 crore[42], instead of ₹0.80 crore, for enhancement of authorised share capital from ₹15 crore to ₹175 crore. Thus, inordinate delay in complying with provisions of the 1956 Act resulted in avoidable additional liability ₹0.40[43] crore to the Company.

The Company replied (July 2015) that enhancement of the authorised share capital required approval of Government of Kerala, which was not received. The Company also stated that it had earned profit of ₹0.48 crore *per annum* on the unpaid dues of ₹0.80 crore considering stock turnover of two months and margins of 10 *per cent* on consumer goods, medicines, etc., traded by the Company.

The reply of the Company is contrary to the facts because the Government directed (March 2010) the Company to take necessary action to increase the authorised capital and as per the AoA, the Company only had to pass an ordinary resolution in the general meeting for enhancement of authorised share capital**.** The reply of the Company that it had made profit on the unpaid statutory fee is not acceptable since the primary responsibility of the Company is to comply with statutes. Further, the Company sells consumer goods, medicines, etc., to consumers at subsidised rate and is dependent on Government grant to make good the loss. Despite the grants, the Company had incurred loss of ₹80.90 crore and ₹89.11 crore during the years 2012-13 and 2013-14 respectively.

The Government agreed with the contention of Audit and reiterated that as per the AoA, the Company had just to pass an ordinary resolution in the general

[38] [(₹175 crore - ₹15 crore)/10,000]*50.
[39] 16 May 2013, 24 November 2014 and 06 June 2015.
[40] Came into force with effect from 01 April 2014.
[41] ₹4000 upto ₹1 lakh, ₹300 for every ₹10,000 increase after ₹1lakh upto ₹5 lakh, ₹200 for every ₹10,000 increase after ₹5lakh upto ₹50 lakh, ₹100 for every ₹10,000 increase after ₹50 lakh upto ₹1 crore and ₹75 for every ₹10,000 increase after ₹1 crore.
[42] [(₹175 crore - ₹15 crore)/10,000]*75.
[43] ₹1.20 crore - ₹0.80 crore.

meeting for enhancement of authorised share capital because Government sanction was already issued in this regard.

Therefore, it is recommended that action should be initiated against the erring authorities of the Company for their failure to take appropriate steps in time as per statute and causing loss of ₹0.40 crore to the Company.

Kerala State Mineral Development Corporation Limited

Loss of revenue

Failure of the Company to provide adequate security and storage for excavated sand resulted in loss of sand worth ₹6.42 crore and consequent loss of revenue to Government.

3.7 Kerala State Mineral Development Corporation (Company) is engaged in exploring, mining, processing, selling, etc., of minerals and mineral substances in the State. Government of Kerala (GoK) engaged (January to March 2010) the Company to desilt and dispose sand from three dam sites, i.e. Malampuzha, Chulliyar and Walayar to tide over the scarcity of construction grade sand in Kerala. The purpose of desiltation exercise was to sell sand at reduced rate[44] to general public, mainly BPL families and to the beneficiaries of EMS/MN housing scheme. Sale proceeds were to be remitted to the Government. A Core Committee[45] was to monitor and supervise the operations. The Company was responsible for ensuring proper storage, security and movement of sand, etc.

As per initial planning, the Company was to identify the land for stockyard and security for the stockyard by outsourcing security personnel. District Collector and the Company were to take steps to recruit required personnel for site supervision, accounting, transportation, etc. The Company was also responsible to set up necessary infrastructure like check posts, site office, etc.

During February to May 2010, the Company excavated and filtered three lakh Cubic Meter (cu. m) of sand. Desiltation of sand was carried out through contractors engaged at the rate of ₹180 per cu. m of sand excavated. Out of excavated sand, 1.35 lakh[46] cu. m was sold until August 2011, leaving a stock of 1.65 lakh cu. m of sand.

As there were allegations (August 2011) of discrepancies in the claim of sand excavated, GoK ordered (September 2011) a vigilance enquiry at the instance of the Core Committee. Vigilance Enquiry Report (December 2012) though did not find any discrepancy in the quantity of sand excavated, recommended that the then Managing Director of the Company should not be appointed in any other PSUs or Corporations under GoK for the official misconduct on his part as Managing Director when he did not record correct measurement of sand excavated.

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[44] ₹1200/ cu. m in February 2010, ₹ 990 in May 2010 and ₹600 in January 2011.
[45] The Core Committee headed by District Collector, Palakkad has members from the Company, Irrigation, Forest, Revenue, Police, Taxes departments and experts from Centre for Earth Science Studies and Centre for Water Resources Development and Management.
[46] 0.85 lakh by direct sale and 0.5 lakh by sale to Government agencies.

There was no desiltation and sale of sand during the vigilance enquiry. At the time of resumption (April 2013) of sales activities, the available stock of sand was found to be just 0.58 lakh cu. m. A quantity of 1.07 lakh[47] cu. m of sand worth at least ₹6.42 crore[48], was washed away/ stolen due to lack of proper storage/ security. The Company reported the theft of sand to the police. The objective of the sand desiltation was also not achieved as the Company had failed to transport the sand to other districts as directed (May 2010) by a Cabinet sub-committee on Reservoir Desiltation.

Audit noticed that there was possibility of sand being stolen, owing to high price variation between market rate (₹1750 per cu. m - ₹2777 per cu. m) and Government rate (₹600 per cu. m - ₹1200 per cu. m) warranting heightened security arrangement. Moreover, the Company did not have any storage facility of its own and the excavated sand was stored at dam sites. Yet, the Company had failed to ensure proper security of the available stock because:

- The desilting of sand was carried out without an estimate of likely sale and capacity of the Company for storing and transporting the unsold sand, resulting in large accumulation of sand.

- The Company had a manpower of only five as on March 2010. Though GoK permitted the Company to recruit site supervisors, accountants and personnel and to outsource security personnel after the commencement of desiltation process, the Company had failed to do so. There was also lack of proper transportation arrangement to carry sand to other districts. Obstruction by local people and rain also affected sale/ transfer of sand.

Thus, failure of the Company to perform the duties assigned to it by GoK, namely, provision of sufficient security to the excavated sand and transportation of sand to other places, resulted in loss of revenue of ₹6.42 crore to the Government and non-achievement of the envisaged objective of the project as the sand could not be distributed to the general public at reasonable price as envisaged by GoK**.**

The Company replied (October 2015) that against 2.71 lakh cu.m of sand excavated, the Company sold 1.74 lakh cu. m and 0.97 lakh cu. m was available in stock as of November 2015. Therefore, there was no shortage of sand and that quantity of sand estimated to be washed away was subsequently found spread over a broad area near the reservoir. GoK endorsed (December 2015) the reply of the Company.

The reply was not acceptable since as *per* the detailed report of Managing Director sent to GoK in November 2010 and July 2012, the excavated and filtered sand was three lakh cu. m. It was also concurred by GoK. Out of the excavated quantity of three lakh cu. m of sand, the Company had sold only 1.74 lakh cu. m of sand so far. The fact that the Company could not dispose of the remaining sand at concessional rate of ₹600 per cu. m as per direction (March 2014) of GoK, further proved that sand had been lost and could not be salvaged.

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[47] Difference between 1.65 lakh and 0.58 lakh.

[48] At the rate of ₹600 per cu. m as fixed by GoK for sale to beneficiaries of EMS/MN housing scheme.

Since the Company has now (since November 2014) been assigned with desilting operations at Pazhassi Dam and proposal for desilting at another dam site (Chamravattom) is pending with the Government, it is recommended that the Company should ensure proper storage of excavated sand by providing protection against seepage and theft. Adequate security arrangements should also be made.

Kerala State Electricity Board Limited

Loss due to undue favour to cable TV operators

Failure of KSEBL to execute agreement with Asianet and other cable TV operators resulted in loss of ₹14.70 crore and short collection of service tax of ₹1.75 crore.

3.8 As per Rule 181 of Kerala Financial Code, no work which is to be executed under a contract should be started until the contractor has signed a formal written agreement. If no formal agreement is executed, there should at least be a written understanding specifying terms and conditions of the contract including prices and rates, etc. All cable TV operators including Asianet Satellite Communications Limited (Asianet) have been using electric poles of Kerala State Electricity Board Limited (KSEBL) for their cable TV operations on payment of annual pole rental of ₹108 for urban areas and ₹54 for rural areas fixed in 2002 based on cost of erection of poles plus margin. Pole rental was subject to annual increase of 12.5 *per cent*. The existing agreement with Asianet for 10 years, upon its expiry in March 2011, was extended (July 2011) up to September 2011. Extension was given subject to the condition that rates would be revised with effect from April 2011 based on the report of an Expert Committee constituted to revise pole rentals.

Based on the report (December 2011) of the Expert Committee, KSEBL increased (February 2012) the annual pole rent to ₹311 in urban/ semi-urban areas and ₹155.50 in rural areas with annual increase of five *per cent* from April 2011 for all cable TV operators. KSEBL did not execute fresh agreement with Asianet reckoning pole rentals suggested by Expert Committee. Asianet and other Cable TV operators, however, continued to use the electric poles of KSEBL.

The Asianet and other cable TV operators challenged the enhanced rate before the Honôble High Court of Kerala. The Court directed (November 2012) KSEBL to charge pole rental at ₹250 in urban/ semi urban areas and at ₹125 in rural areas, as an interim arrangement, subject to ña final appropriate decision to be taken by KSEBL after considering the representation of cable TV operatorsò. KSEBL considered the representations and decided (January 2014) to uphold the enhancement of pole rentals i.e. ₹311 in urban and ₹155.50 in rural areas as done in February 2012. Meanwhile, Asianet filed a petition before District Legal Services Authority[49] (DLSA), Thiruvananthapuram against the decision of KSEBL. In the Lok Adalat held (August 2014) by DLSA, as part of a mutual settlement between Asianet and other cable TV operators and KSEBL at the instance of Minister for Power and Transport and other political leaders/representatives, pole rental was finally fixed at ₹250 in urban/semi-urban areas and ₹125 in rural areas with an annual increment of five *per cent* for the period from 2011-12 to 2020-21. KSEBL had also decided (September 2014) to apply the same pole rental to all cable TV operators using electric poles of KSEBL in the State. Reduction of pole rental to ₹250 for urban/ semi-urban areas and ₹125 for rural areas as part of a mutual settlement before Lok Adalat was unjustified. Reduction of pole rental as part of a mutual settlement before Lok Adalat resulted in loss of pole rental amounting to ₹14.70 crore and short collection of service tax of ₹1.75 crore during 2011-12 to 2014- 2015.

It was observed by Audit as under:

- the revised rates of ₹250 and ₹125 for urban and rural areas respectively were not only lower than the rates fixed by Expert committee but even lower than the pre-April 2011 rates of ₹277.06[50] (urban area) and ₹138.53 (rural area) as shown in *Table* below:

Table 3.12: Details of pole rentals charged by KSEBL

(Amount in ₹)

Urban/Semi urban areas			Rural areas		
Pole rental as per existing agreement up to April 2011	Rate revised from April 2011 for all cable TV operators	Rate finally agreed from April 2011 for all cable TV operators	Pole rental as per existing agreement up to April 2011	Rate revised from April 2011 for all cable TV operators	Rate finally agreed for all cable TV operators
277.06	311.00	250.00	138.53	155.50	125.00

- KSEBL›s settlement of rent by downward revision ñas a matter of goodwill and to put to rest prolonged litigationò was against the commercial interest of the Company, which was also upheld by the High Court.

- Asianet had been using poles of KSEBL from November 1992 onwards. Valid agreements were also in force up to September 2011. Therefore, KSEBL did not have to go in for out of court settlement and petitions of Asianet challenging rate enhancement of pole rentals in 1999 and 2005 were dismissed by Honõble High Court.

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[49]The National Legal Services Authority (NALSA) has been constituted under the Legal Services Authorities Act, 1987 to provide free legal service to the weaker sections of the society and to organise Lok Adalats for amicable settlement of disputes. In every State, State Legal Services Authority has been constituted to give effect to the policies and directions of NALSA. In every District, District Legal Services Authority has been constituted to implement Legal Services Programmes in the District. The District Legal Services Authority is situated in the District Courts Complex in every District and chaired by the District Judge of the respective district.

[50] An appeal filed by Asianet against this rate was also pending before the Court.

KSEBL replied (September 2015) that it had upheld the revised rate on the Hon'ble High Court's interim order and the decision for downward revision, to a meagre extent, was taken after considering representations of various political parties, people's representatives and associations of cable TV operators and to avoid litigation. It was further replied (December 2015) that Asianet was remitting revised pole rental charges, in spite of disputes regarding the number of poles and rate, even though there was no existing formal agreement.

The reply is not acceptable since reduction of rate was due to absence of a conclusive agreement. Besides, KSEBL had taken the appropriate decision to uphold rate enhancement after considering the representations of cable operators as directed by Hon'ble High Court. Subsequent downward revision in the Lok Adalat at the instance of Minister for Power and Transport, Government of Kerala and other political representatives as admitted by the KSEBL resulted in loss of pole rental of ₹14.70 crore to KSEBL. In the absence of agreement, pole rentals paid by Asianet was at the reduced rate (₹250 for urban and ₹125 for rural areas) and not at an enhanced rate (₹311 for urban and ₹155.50 for rural areas).

Avoidable expenditure

Avoidable expenditure of ₹68.31 lakh due to delay in surrendering railway siding.

3.9 KSEBL owned a railway siding under its Building and Stores Division at Angamaly for transportation of bulk quantity of departmental material like steel, cement, high quality structural steel and special machineries, etc., required for implementation of various projects of KSEBL. The railway siding was beneficial to KSEBL as transportation of material through rail was cheaper compared to the freight charges by road. As per agreement with Southern Railway, KSEBL was to pay annual maintenance charges for the railway siding.

In June 2007, KSEBL changed conditions of tenders for implementation of projects. According to new conditions, cement and steel supplied departmentally hitherto became the responsibility of contractors. Thereafter, supply of departmental material to contractors was limited in respect of transmission wing only. Hence, the railway siding ceased to be in use and no material was transported by the Railways using railway siding since 2010.

As annual maintenance charges paid to the Railways increased in line with the salary and allowances of Railways' staff, despite there being no usage of railway siding, Financial Adviser of KSEBL recommended (June 2010) the Board to discontinue operation of railway siding. The Board, however, decided (November 2010) to continue the railway siding since a proposal for installation of a 1026 MW[51] Liquified Natural Gas based Combined Cycle Power Plant at Brahmapuram (LNG project) was in the pipeline and it was expected that the railway siding would be needed to handle the equipment for

[51] **Mega Watt.**

the proposed plant. The LNG project was subsequently abandoned (February 2011) as the land earmarked for the LNG project was handed over to Government of Kerala (GoK) for Smart City Project. Thereafter, KSEBL decided (November 2013) to surrender the railway siding.

Due to delay in surrender of railway siding, KSEBL had to incur avoidable expenditure of ₹68.31[52] lakh during November 2010 to November 2013 towards annual maintenance charges.

KSEBL replied (January 2016) that decision to surrender the railway siding was not taken until November 2013 as large projects like installation of 400 MW Combined Cycle Power Plant at Brahmapuram and replacement of faulty Diesel Generating units of Brahmapuram Diesel Power Project with gas based generators were under active consideration.

The reply was not acceptable as KSEBL's decision (30 November 2010) to continue the railway siding was based solely on the requirement to handle equipment for the LNG project at Brahmapuram. The land ear-marked for LNG Project was handed over to GoK in July 2007 and request (April 2010) of KSEBL to transfer the land back was turned down by GoK.

The matter was reported (December 2015) to Government; their reply is awaited (December 2015).

Avoidable expenditure

Avoidable expenditure due to delay in payment of excise duty- ₹64.82 lakh

3.10 As per Rule 9 of Central Excise Rules, 2002, every manufacturer of dutiable goods is required to obtain Central Excise registration from Central Excise authorities for payment of excise duty. Central Excise Authorities would issue the Registration Certificate in a couple of working days after submission of online registration form.

Following the introduction (February 2011) of Finance Bill 2011, excise duty became payable with effect from March 2011 on galvanisation of line material since the galvanisation was categorised under "manufacturing" in the Finance Bill 2011. Mechanical Fabrication Units (MF Units) Angamaly and Kolathara of KSEBL, responsible for the job of galvanisation works in KSEBL were, therefore, to pay excise duty on value of material galvanised with effect from March 2011 after registration with Central Excise Authorities.

MF Units Angamaly and Kolathara obtained Central Excise registration only in February 2012 and March 2012 respectively and paid excise duty in March 2012. While paying excise duty in March 2012, MF Unit Kolathara did not pay arrears of excise duty from March 2011 to February 2012. The arrears of excise duty was paid in November 2014 only, on being pointed out by the Central Excise Authorities. Due to delay in payment of excise duty on galvanised material from March 2011 onwards, KSEBL had to pay avoidable

[52] **₹13.85 lakh in 2010-11, ₹11.79 lakh in 2011-12, ₹19.23 lakh in 2012-13, ₹ 21.68 lakh in 2013-14 and ₹1.76 lakh in 2014-15.**

interest of ₹49.80 lakh and penalty of ₹15.02 lakh on galvanised material cleared from March 2011 to February 2012.

Although registration with Central Excise authorities could have been obtained immediately and was mandatory for payment of excise duty with effect from March 2011, the Member (Generation Projects) brought the matter to the notice of Full Time Members only in November 2011. KSEBL issued order to obtain Central Excise Registration in January 2012 after a delay of 11 months from the date of promulgation (February 2011) of Finance Act 2011.

Thus, delay on the part of KSEBL to issue orders for central excise registration coupled with delay in payment of excise duty arrears resulted in avoidable payment of interest and penalty of ₹64.82 lakh.

The Company confirmed the facts of the case in its reply (January 2016).

Kerala State Beverages (Manufacturing & Marketing) Corporation Limited

Avoidable expenditure

Failure in timely passing on the incidence of additional tax (i.e. medical cess) to consumers resulted in payment of tax of ₹2.10 crore. Besides, delay in payment of medical cess resulted in avoidable payment of interest of ₹0.42 crore.

3.11 Kerala State Beverages (Manufacturing & Marketing) Corporation Limited (Company) is a public sector undertaking engaged in wholesale and retail trade of liquor in Kerala. Under Section 5 of the Kerala General Sales Tax Act, 1963, the Company is liable to pay sales tax to Government of Kerala (GoK) on sale of liquor. GoK imposed (28 July 2012) medical cess[53] at the rate of one *per cent* on sales tax payable by the Company with effect from 28 July 2012 to mobilise funds for supplying generic medicines free of cost. Medical cess was payable along with monthly sales tax on or before the tenth day of the succeeding month.

The Company, however, passed on the incidence of medical cess to customers by increasing price of liquor with effect from 16 August 2012 only due to delay in revising the Maximum Retail Price (MRP) of various brands of liquor sold. As a result, during the intervening period between 28 July 2012 and 15 August 2012, the Company could not collect and pay medical cess amounting to ₹2.10 crore. Due to non-payment of medical cess for the above period, Commercial Tax Department, GoK directed (November 2014) the Company to pay medical cess of ₹2.10 crore along with interest of ₹0.42 crore. Accordingly, Company paid (December 2014) ₹2.52 crore out of its income.

Audit noticed that GoK had ordered to levy medical cess on 30 June 2012, but the effective date of levy was not specified in the order of GoK. Despite this ambiguity in the order of GoK, the Company did not make any attempt to

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[53] **Medical cess is a tax on tax, levied by the Government for providing generic medicine free of cost to poor patients.**

ascertain the effective date of levy and make preparatory arrangements in advance to implement the Government Order. This was necessary for making arrangements for passing on the burden of medical cess to consumers by revising the MRP. Consequently, when Government notification was issued on 28 July 2012 to impose levy of medical cess with immediate effect i.e. from 28 July 2012, the Company was unprepared for collecting additional medical cess from the consumers even though it was well aware of the impending cess / order as early as 30 June 2012.

Thus, failure of the Company in passing on the incidence of cess to customers on time and delay in payment led to avoidable payment of ₹2.10 crore as medical cess and ₹0.42 crore as interest out of its profits.

Government replied (January 2016) that for collecting the medical cess from customers, new MRP had to be worked out for all brands of liquor and new MRP entered into billing machines. Therefore, the Company implemented the revised MRP with effect from 16 August 2012.

The reply was not acceptable since the Company was aware of the impending medical cess as early as 30 June 2012. Lack of preparedness on the part of the Company was the reason for non-collection of medical cess from the consumers.

Statutory corporations

Kerala State Road Transport Corporation

Irregular payment of performance allowance

Irregular payment of performance allowance of ₹3.24 crore in violation of Government Order.

3.12 According to Section 34 of Road Transport Corporation Act, 1950, State Government can issue instructions to Road Transport Corporations on matters relating to recruitment, wages to be paid to employees, etc. Road Transport Corporations shall not depart from the directions without prior permission of State Government.

Transport Department, Government of Kerala (GoK), while ratifying (February 2015) payment of performance allowance[54] of ₹2.13 crore and ₹2.97 crore for the years 2012-13 and 2013-14 respectively to the employees of Kerala State Road Transport Corporation (Corporation), had ordered that performance allowance should not be paid in future without prior approval of GoK.

The Corporation is a 'loss making'[55] PSU with no worthwhile performance to

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[54] Allowance given to employees as an appreciation towards their best performance.

[55] Loss of the Corporation as per the last five finalised accounts were: ₹508.22 crore (2012-13), ₹412.78 crore (2011-12), ₹376.89 crore (2010-11), ₹237.95 crore (2009-10) and ₹117.12 crore (2008-09). Accumulated loss up to 31 March 2013 was ₹3025.90 crore as per the latest finalised accounts (2012-13).

report upon. Its loss had increased from ₹117.12 crore in 2008-09 to ₹508.22 crore in 2012-13. Further, considering the severe financial crisis faced by the Corporation, a revival package approved (February 2014) by GoK was under implementation.

For the year 2014-15, the Corporation, based on the orders of the Chairman and Managing Director, paid performance allowance of ₹3.24 crore to its 29,478 employees without obtaining prior approval of GoK and without linking performance allowance with any significant performance or achievement. In reply to the queries of Audit in connection with the payment of performance allowance to its employees for the periods 2012-13 to 2013-14, Finance Department, GoK replied (January 2016) that they had neither accorded sanction to pay the performance allowance nor ratified the action of Transport Department. Ratification of performance allowance paid to employees for the periods 2012-13 to 2013-14 was stated to be accorded by the Cabinet. Though the Transport Department was requested to provide the copies of the cabinet decision, they have not responded as yet (January 2016).

Since the Corporation was incurring loss continuously and was facing severe financial crisis, payment of performance allowance was unjustified and ratification of the payment by the Government overruling its own orders on the subject was also not justified.

Thiruvananthapuram, **(AMAR PATNAIK)**

The 03 MAY 2016 **Principal Accountant General**

(Economic & Revenue Sector Audit)

Kerala

Countersigned

New Delhi **(SHASHI KANT SHARMA)**

The 16 MAY 2016 **Comptroller and Auditor General of India**