

Chapter IV

Compliance Audit Observations

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

Government companies

Malabar Cements Limited

4.1 Procurement management

Introduction

4.1.1 Malabar Cements Limited (Company) was incorporated in April 1978 with the main objective of manufacturing cement using limestone available at the mining area leased to the Company by the Government of Kerala (GoK). The Company manufactures three types of cement, *viz.*, Pozzalana Portland Cement, Ordinary Portland Cement and Portland Slag Cement and markets them in the brand names ‘Malabar Classic’, ‘Malabar Super’ and ‘Malabar Aiswarya’ respectively. Besides limestone, laterite, gypsum, clinker and fly ash are the major raw material used for production of cement. During 2014-15 to 2016-17, the Company issued 104 purchase orders for procurement of material at an aggregate value of ₹371.85 crore. The value of raw material purchased ranged from 41.15 *per cent* (2014-15) to 50.98 *per cent* (2015-16) of the total expenditure.

Audit reviewed the procurement of material by the Company, with the following audit objectives:

- Whether procurement of material was properly planned taking into account the overall requirements; and
- Whether the prescribed guidelines/regulations for tendering and procurement were duly adhered to and the material procured was as per the quality standards.

Audit examined 21 out of 40 tenders and 49¹ purchase orders (POs) valuing ₹190.88 crore out of 104 purchase orders issued during 2014-15 to 2016-17.

Audit Findings

4.1.2 The procurement process of the Company is governed by Purchase Policies and Procedures 2010 of the Company, provisions of Stores Purchase

¹ All 17 POs with value above ₹5 crore, 19 POs out of 37 POs with value between ₹1 crore and ₹5 crore and 13 POs out of 50 POs with value below ₹1 crore. Out of the 49 POs, 27 POs were direct procurement from Central/State PSUs.

Manual 2013 (SPM) issued by GoK, the Central Vigilance Commission (CVC) guidelines and Government orders. According to the Purchase Policies and Procedures of the Company, procurement process in the Company shall start with user departments raising purchase indents to meet targeted production of cement during the ensuing year. The purchase indents shall be approved by the Chief Engineer (Instrumentation). Thereafter, tenders shall be invited and POs issued for procurement.

Audit observations on the above are discussed below.

Purchase Policy and Procedure

Time frame for procurement process

4.1.3 Procurement process included different stages like budgeting, raising of purchase indents, inviting and finalisation of tenders and issue of Purchase Orders. Clause 1.3(i) of the SPM stipulated that to reduce delays, each department should prescribe appropriate time frame for each stage of procurement; delineate the responsibility of different officials and agencies involved in the purchase process and delegate, wherever necessary, appropriate purchase power to the lower functionaries with due approval of the competent authority. Clause 6.1 of SPM also stated that purchasing authority should estimate material requirements for a year as far as can be foreseen. At the end of each financial year, each department should realistically assess its requirements of stores and equipment 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.

Audit observed that:

- Against the stipulation that material requirement for the next financial year should be assessed at the end of current financial year *i.e.*, 31 March, the Company assessed requirement for 2014-15 on 28 June 2014 (delay of 89 days), for 2015-16 on 20 May 2015 (delay of 50 days) and for 2016-17 on 04 October 2016 (delay of 187 days).
- The non-compliance of provisions of SPM also resulted in fixation of different time periods for bids' validity and avoidable delays in the procurement of material as detailed in **Paragraph 4.1.5**.

GoK replied (November 2017) that majority of suppliers/prospective bidders dealt with private sector only and that they were not inclined to the procedural practice of PSUs. The reply of GoK was not acceptable as procedures to be followed by the Company was internal to the Company and did not have any relation with the prospective suppliers.

Updation of Purchase Policies and Procedures

4.1.4 GoK directed (October 2012) all Public Sector Undertakings (PSUs) to make e-procurement mandatory for all purchases having value above ₹25 lakh with effect from 31 March 2013 to enhance transparency in public procurement. In June 2013, GoK amended the Stores Purchase Manual (SPM), making e-procurement mandatory for all purchases with value above ₹25 lakh². Further, as per the directions (October 2013) of GoK, re-tender was to be resorted to in case of single bid.

Audit observed that the Company did not make any changes in its Purchase Policies and Procedures in order to incorporate the changes on mandatory e-procurement. Audit also observed that after the amendment (June 2013) of SPM, the Company invited three³ e-tenders for transportation of fly ash. In violation of the directions of GoK, the Company, however, resorted to conventional tendering (September 2015) in one work for collection and transportation of dry fly ash from Hindustan Newsprint Limited, Velloor, Kottayam (HNL) to Cement Grinding Unit, Cherthala/ factory at Walayar even though the estimated value of the work was ₹1.15 crore. In the conventional tendering, the Company received only one offer from Jayalakshmi Enterprises and the work order was placed on the lone bidder without going for re-tender. Thus, the Company's decision to award the work to Jayalakshmi Enterprises was irregular. Approval was also not obtained from GoK for the deviation.

GoK replied (November 2017) that conventional tendering was resorted to as directed by the Board of Directors in order to get competitive rates and there was price reduction ranging from ₹141/MT to ₹40/MT for transportation of dry fly ash in the conventional tender floated. Further, this was a one-time deviation in order to elicit more response and to reduce cost. The reply was not acceptable as even the Board of directors was not empowered to permit violation of Government order. Further, as conventional tender floated by the Company also received only a single bid, the claim of the Company that the Company was benefited with reduction in price was not verifiable. Moreover, the transparency as envisaged in the Government order was not ensured.

Invitation of tenders and issue of purchase orders

Fixation of validity of tenders

4.1.5 Clause 7.33 (x) of the Stores Purchase Manual issued by GoK stipulated that the tender for procurement of material should specify a period of firmness during which bidders should keep their rate firm. The time fixed for firmness of offers should be enough to cover the normal delay expected in placing supply orders after going through all the formalities. Further, as per Clause 9.58 of the SPM, the entire process of scrutiny and evaluation of tenders, preparation of ranking statement and notification of award must be done within the original tender validity period. The validity period should not be

² GoK (May 2015) lowered e-procurement slab from ₹25 lakh to ₹5 lakh.

³ Tender Nos.684/2013 dated 13 August 2013, 695/2014 dated 24 April 2014 and 696/2014 dated 24 April 2014.

unreasonably long as keeping the tender unconditionally valid for acceptance for longer period entails the risk of the tenderers demanding higher prices. As per Clause 9.58 of SPM, generally, the validity period should not be more than three months from the date of tender opening.

Audit observed that:

- The Company did not follow the provisions of SPM regarding validity period for tenders. Out of 21 tenders selected for scrutiny, the Company insisted for longer tender validity period of four months in respect of seven tenders⁴. As such, the Company did not ensure the period of firmness envisaged by the SPM.
- Out of 21 tenders test checked, in one⁵ tender (March 2016) for procurement of 40,000 MT of imported coal, the Company did not issue PO within the offer validity period of 60 days from the date of opening of the tender. The rate of ₹6,344 per MT quoted by Mohit Minerals Private Limited, the lowest bidder, was firm and valid upto 2 July 2016. The Company issued Letter of Intent (LoI) only on 20 July 2016, after expiry of validity of offer. Accepting the LoI, the supplier demanded modifications like change of port of unloading, splitting of bill of lading instead of single bill of lading insisted by the Company, etc. Accepting these conditions, Managing Director of the Company directed (05 September 2016) to issue POs to Mohit Minerals Private Limited. But, the direction was not complied with by Company officials.

The Company cancelled (October 2016) the above tender and procured 7,459 MT of imported coal (3,773 MT in November 2016 and 3,686 MT in January 2017) from the State Trading Corporation of India Limited (STC) without inviting tenders, at the rate of ₹8,689 per MT, in order to meet the emergency requirements. Thus, the Company incurred an extra expenditure of ₹1.75 crore on procurement of 7,459 MT imported coal due to non-issue of PO within the validity period of the offer, which subsequently resulted in cancellation of tender.

Apart from the extra expenditure, there was non-availability of imported coal for production of cement until its emergency procurement from STC. As a result, the Company stopped production of cement at Walayar plant from 23 September 2016 to 19 November 2016. The production loss of cement was 1.33 lakh MT, with resultant loss of contribution⁶ of ₹2.16 crore. Thus, by failing to finalise the bids within the validity period as envisaged in SPM, the Company incurred a net loss of ₹3.91 crore.

The Company admitted (August 2017) the delay in issue of PO and stated that extra expenditure was due to unpredicted hike in the price of

⁴ Tender Nos. 692 dated 07 February 2014, 707 dated 30 July 2014, 718 dated 13 October 2014, 725 dated 13 December 2014, 737 dated 12 September 2015, 740 dated 26 November 2015 and 744 dated 11 January 2016.

⁵ Tender No.750 dated 04 March 2016.

⁶ Contribution is the difference between selling price and variable cost of cement. Contribution per MT for 2016-17 was ₹1,621.32.

imported coal as price in the global market was in the upward trend. The reply of the Company was not acceptable as despite knowing the upward trend in price of the product, the Company did not issue PO within the validity period.

GoK replied (November 2017) that the delay was due to request for changes in terms and conditions of contract by the supplier. After acceptance of the conditions of the supplier, PO was not issued because the Managing Director of the Company was removed and consequently, there was vacuum in decision making. Further, the sudden spurt in coal prices could not be predicted. The reply of GoK was not correct as the Company already accepted the conditions of supplier and decision was also taken to issue purchase orders. Non-issue of PO within the validity period of offer also resulted in extra expenditure on alternate procurement and production loss.

Splitting of Purchase Orders

4.1.6 According to the directions of CVC⁷ and provisions of SPM (Clause 9.50), tendered quantity should be split among bidders other than the lowest bidder only if the lowest bidder is incapable of supplying the full quantity. Items of critical or vital nature can be sourced from more than one source if the ratio of splitting is pre-disclosed in the tender itself. CVC has also emphasised that conditions in the tender did not authorise tender accepting authority to take decisions in an arbitrary manner.

Audit observed that:

- In 4 out of 21 tenders selected for detailed scrutiny, the Company divided the tendered quantity to multiple bidders at L1 rate even though L1 bidder was ready to supply the entire quantity as shown in **Table 4.1:**

Table 4.1: Details of splitting up of tenders

Sl. No.	Tender No	Name of item	Tendered quantity	Quantity to L1 bidder	Quantity to other bidders
1	736/2015	Imported Clinker	1.20 lakh MT	0.60 lakh MT	0.60 lakh MT
2	694/2014	Imported Coal	0.40 lakh MT	0.20 lakh MT	0.15 lakh MT
3	707/2014	Unlaminated Bags	60 lakh bags	54 lakh bags	6 lakh bags
4	720/2014	Laminated Bags	60 lakh bags	45 lakh bags	15 lakh bags

(Source: Purchase orders issued by the Company)

- In the tender for supply of 0.40 lakh MT of imported coal (serial number 2 of **Table 4.1**), Quantum Coal Energy Private Limited, the L1 bidder did not agree (June 2014) to supply part quantity of 0.20 lakh MT citing that the price quoted by them was based on the tendered quantity of 0.40 lakh MT. The Company, subsequently purchased (August 2014) the item from other suppliers at L1 rate.

⁷ Circular No.4/3/2007 dated 03 March 2007.

- There was no recorded reason for splitting the tendered quantity.

This resulted in non-compliance to provisions of SPM and deviation from CVC guidelines and thus, transparency in the procurement process was not ensured.

GoK replied (November 2017) that the provision regarding the splitting of quantity was mentioned in the tender. The reply of GoK was not acceptable since such clause for splitting of orders can be incorporated in tenders only for critical or vital item, that too after specifying the ratio of splitting. The Company incorporated clause for splitting of tender in all the 21 tenders examined by Audit instead of limiting this to critical items. Moreover, the Company did not specify the formula to be adopted in case of splitting of tendered quantity as required under Clause 9.50 of SPM.

Collection of Earnest Money Deposit (EMD)

4.1.7 Clause 8.2 of SPM stipulated the bidders to furnish EMD at the rate of one *per cent* of the total cost of the articles tendered when the Probable Amount of Contract (PAC) is ₹1 lakh or more. However, in the Purchase Policies and Procedures of the Company, EMD was limited to three lakh rupees when the value of PAC exceeded ₹1 crore. Limiting the amount of EMD was in violation of provisions of SPM. The Company restricted collection of EMD to ₹3 lakh in all 13 tenders⁸ having PAC above ₹3 crore test checked, resulting in short collection of EMD to the extent of ₹1.67 crore.

GoK accepted the observation and replied (November 2017) that it was decided to follow the EMD conditions as per SPM without any deviation with immediate effect.

Safeguards for ensuring performance of the contract

4.1.8 SPM envisages collection of security deposit for ensuring due performance of the contract. The SPM also provides for levy of liquidated damages and invocation of risk and cost for delay and failure to supply. Non-compliance of the Company to these requirements is discussed below.

Collection of security deposit

4.1.9 In order to ensure due performance of the contracts, Clause 8.19 of SPM, specified collection of the security deposit equivalent to five *per cent* of the total value of the contract. Further, as per Clause 8.30 of SPM, the security deposit shall be forfeited in the event of breach of contract.

Audit observed that:

⁸ Tender No. 694 dated 21/03/2014, 696 dated 24/04/2014 707 dated 30/07/2014, 709 dated 02/08/2014, 720 dated 07/11/2014, 722 dated 19/11/2014, 723 dated 01/12/2014, 725 dated 13/12/2014, 736 dated 24/08/2015, 737 dated 12/09/2015, 750 dated 04/03/2016, 753 dated 07/11/2016 and 766 dated 30/01/2017.

- In violation of SPM, Clause 16(d) of the Purchase Policies and Procedures of the Company stipulated collection of security deposit at five *per cent* of three months' order value for annual contracts. As a result, in 11 out of 21 tenders selected for scrutiny, there was short collection of security deposit to the extent of ₹2.03 crore⁹ as detailed in **Table 4.2**:

Table 4.2: Details of short collection of security deposit

(₹ in lakh)

Sl. No.	Tender No.	Name of contractor	Security deposit to be collected as per SPM (a)	Security deposit collected (b)	Short collection (a-b)
1	698 dated 29/05/2014	SK Transports	23.88	5.97	17.91
2	718 dated 13/10/2014	Velmurugan Transport	25.01	6.25	18.76
3	725 dated 13/12/2014	Uzhavan Lorry Transport	12.11	3.03	9.08
4	737 dated 12/09/2015	Uzhavan Lorry Transport	15.31	4.05	11.26
5	740 dated 26/11/2015	NSS Logistics (India) Pvt. Ltd.	1.55	0.39	1.16
6	744 dated 11/01/2016	Muthaiya Transport	12.34	5.00	7.34
7	691 dated 22/02/2014	Vijayalakshmi Transports	18.00	7.15	10.85
8	686 dated 18/01/2014	Raja Transports	18.66	0.00	18.66
9	759 dated 10/10/2016	Sri. Balaji Mines & Minerals	22.50	0.00	22.50
10	707 dated 30/07/2014	Sri Shanmuga Polimers (P) Ltd.	53.73	8.96	44.77
11	720 dated 07/11/2014	Brocade India Polytex Limited	48.95	8.16	40.79
Total			252.04	48.96	203.08

(Source: Details furnished by the Company)

In 3 out of the 11 above tenders, the contractors did not supply the ordered quantity of material and consequently, in two cases (serial numbers 7 and 8 of **Table 4.2**), the Company had to procure the same from alternate sources at extra expenditure of ₹1.10 crore. In the remaining one case (serial number 9 of **Table 4.2**) there was production loss of ₹7.27 crore. The Company did not collect any security deposit against two tenders (serial numbers 8 and 9 of **Table 4.2**). Due to short-collection of security deposit against the provisions of SPM, the Company did not make good the loss to the extent of ₹52.01 lakh by forfeiting the same.

The Company replied that security deposit at the rate of five *per cent* of three months' order value was fixed to obtain more offers. However, the Company realised that this was not enough to recover the penalty in case of breach of

⁹ Security deposit to be collected as per SPM was ₹2.52 crore. Actual collection of security deposit was ₹0.49 crore. Hence, the short collection of ₹2.03 crore.

contract. Therefore, the Company started following the provisions of SPM since April 2017. The reply that the security deposit at the rate of five *per cent* of three months' order value was fixed to get more offers was not acceptable as it was a violation of SPM.

GoK replied (November 2017) that the Company modified the security deposit clauses in line with provisions of SPM.

Levy of liquidated damages and invoking of risk and cost purchase clause

4.1.10 In case of delay in delivery of goods, Clause 10.31 of the SPM provided for levy of liquidated damages (LD) at the rate of 0.50 *per cent* to 1.00 *per cent* of the value of the delayed stores for each week of delay up to a maximum of 10 *per cent* of the contract price of the delayed stores. Once the maximum is reached, the purchaser may consider for termination of the contract at the risk and cost of the contractor.

Audit observed that the Company included different LD clauses in different tenders/POs. In case of six tenders¹⁰ for transportation, the Company fixed rate of liquidated damages at the rate of ₹10 per MT, which was too meagre compared to transportation cost which ranged from ₹622 to ₹1,940 per MT. In case of 13¹¹ tenders for supply of raw material, levy of LD for delayed delivery was specified at the rate of 0.50 *per cent* per week subject to a maximum of 5.00 *per cent* on the value of unexecuted portion of supply.

Audit also observed that the POs contained provisions to terminate the orders in case of default. But, the Company did not terminate the contract to recover extra cost of procurement from the delinquent supplier in four tenders as discussed in **Paragraph 4.1.11**.

Non-termination of contract

4.1.11 Against four tenders for procurement of laterite II and III and transportation of limestone, the Company issued purchase orders to the respective L1 bidders. These parties supplied only meagre quantity within the scheduled time as shown in **Table 4.3**:

¹⁰ Tender Nos. 698 dated 29/05/2014, 718 dated 13/10/2014, 725 dated 13/12/2014, 737 dated 12/09/2015, 740 dated 26/11/2015 and 744 dated 11/01/2016.

¹¹ Tender Nos. 692 dated 07/02/2014, 694 dated 21/03/2014, 705 dated 25/07/2014, 709 dated 02/08/2014, 722 dated 19/11/2014, 733 dated 27/07/2015, 736 dated 24/08/2015, 745 dated 14/01/2016, 749 dated 01/03/2016, 750 dated 04/03/2016, 753 dated 07/11/2016, 759 dated 10/10/2016 and 766 dated 30/01/2017.

Table 4.3: Details of short supply of material

Sl. No.	Particulars	Ordered Quantity (MT)	Name of L1 bidder	Short Supplied Quantity (MT)	Impact
1	Supply of Laterite II (Tender No. MCL/02/PRT/733/2015 dated 27/07/2015)	5,000	Vikraam Enterprises	4,896.76	The Company incurred extra expenditure of ₹92.52 lakh for alternate purchase.
2	Supply of Laterite III (Tender No. MCL/BM/759/2016 dated 10/10/2016)	12,000	Sri. Balaji Mines & Minerals	11,745.92	Due to non-supply of material, the Company purchased lower grade laterite from other sources and there was production loss of cement to the extent of 54,283 MT and contribution loss to the extent of ₹7.27 crore.
3	Transportation of limestone (Tender No. MT/02/PRT/686/2013 dated 01/10/2013)	60,000	Raja Transports	59,609.00	Incurred extra expenditure of ₹41.41 lakh due to alternate procurement.
4	Transportation of limestone (Tender No. MT/02/PRT/691/2014 dated 30/01/2014)	50,000	Vijayalakshmi Transports	24,846.61	Incurred extra expenditure of ₹68.33 lakh due to alternate procurement.

(Source: Details furnished by the Company)

Audit observed that due to non-supply of material, the above contracts were required to be terminated by the Company as per provisions of SPM when maximum Liquidated Damages (10 *per cent*) leviable was reached. The Company did not terminate the contract to recover risk and cost amount of ₹2.02 crore¹² incurred in procurement from alternate sources in three cases as the necessary clause for invoking risk and cost was not included in the PO.

GoK replied (November 2017) that supply of laterite by Vikraam Enterprises and Sri. Balaji Mines & Minerals was interrupted due to closure of their mine on technical issues. Further, in the absence of suitable bidders/suppliers for laterite and anticipating reopening of their mines at the earliest, so that the Company could be benefited by the low cost of material in comparison to the present procurement rate, the contracts were not terminated. The Company did not make any payment to these parties for the material supplied. Further, in case of transportation contract, legal proceedings were on to collect all dues from these parties. The reply of GoK was not acceptable as the payment withheld by the Company was too meagre (₹11.26 lakh) compared to the extra expenditure and contribution loss incurred by the Company. Further, the suppliers did not have any contractual liability to supply to the Company in future. The only option available with the Company to mitigate loss on account of alternate purchase due to non-supply of material was termination of contract at the risk and cost, which the Company did not do.

¹² ₹92.52 lakh + ₹41.41 lakh + ₹68.33 lakh.

Receipt and utilisation of material

Procurement of coal without exercising quality checks

4.1.12 As per Clause 11.1 of the SPM, before accepting the ordered stores, it must be ensured that the stores were manufactured as per the required specification and are capable of performing the functions as specified in the contract. The Company was procuring linkage coal through Fuel Supply Agreement (FSA) with the Singareni Collieries Company Limited (SCCL). As per FSA, SCCL will supply coal Grade 7- Crushed Run of Mine coal (G7 CRR) grade and below¹³, which has Gross Calorific Value (GCV) of 5,500 KCal per Kg or less. The price varied with the grade. As per Clause 6.2 of the FSA, coal shall be supplied on 'declared grade basis' from the respective despatch points. It was the responsibility of the Company to check and ensure the quality of coal at the despatch/loading point itself.

Audit observed that the Company did not have any mechanism to check quality of linkage coal at the despatch point. Scrutiny of chemical analysis reports of the Company revealed that during the period April 2014 to March 2017, the Company received 93,240.34 MT of coal from SCCL, out of which, only 11,712 MT was of declared grade. The Company did not check and ensure quality of linkage coal at the despatch point itself, which resulted in extra expenditure of ₹3.89 crore due to payment of higher price for lower grade coal.

GoK replied (November 2017) that the new Fuel Supply Agreement executed (April 2017) with SCCL contained provisions for third party inspection to ascertain the quality of coal loaded. The third party inspection was to be arranged by SCCL and SCCL was in the process of finalising the procedure for third party inspection.

The reply was not acceptable since, as per the existing Fuel Supply Agreement, it was the responsibility of the Company to ensure quality of coal at the despatch/ loading point itself. Failure to do so resulted in avoidable extra expenditure of ₹3.89 crore.

The third party inspection envisaged in the new Fuel Supply Agreement was not yet operational. Thus, GoK needs to expedite the placement of the mechanism of third party inspections for procurement of linkage coal.

Non-compliance to BIS standards

4.1.13 As per Clause 3 of the Cement (Quality Control) Order, 2003 issued (February 2003) by Government of India, cement products cannot be sold in market without the standard mark of the Bureau of Indian Standards (BIS). As BIS marking is mandatory for cement, the Company obtained BIS certification mark for its Cement Grinding Unit (CGU) at Cherthala. The approved

¹³ In the order of G- 7, G- 8, G- 9, etc.

manufacturing process for production of cement at CGU was inter-grinding of clinker, gypsum and fly ash.

The Company placed (March 2015) a PO to Cement Corporation of India Limited (CCIL) for procurement of 2,577 MT Ordinary Portland Cement (OPC). The OPC procured from CCIL was intended to be sold by the Company in its brand name. CCIL delivered the entire quantity of 2,577 MT in March 2015 and the Company stored the same at Kerala State Warehousing Corporation (KSWC) godown by incurring an expenditure of ₹46.22 lakh. Out of 2,577 MT, the Company sold 399.50 MT of OPC between June 2015 and August 2015.

As there was lack of demand and the storage period exceeded more than three months, the Company utilised 2,138 MT of OPC for re-processing into Pozzalana Portland Cement (PPC) during October 2015 to June 2016 along with imported clinker for inter grinding with other raw material. Audit observed that this process was not an approved manufacturing process. Based on the inspections carried out by BIS authorities from 23 to 25 May 2016, it was ordered to stop marking of BIS standard from 10 June 2016 citing that the production process at CGU was not as per the manufacturing process approved by BIS and sealed one silo¹⁴ containing 527.15 MT of PPC and 49.40 MT of OPC. The Company later utilised these PPC and OPC cement for internal construction work.

The Company stopped production from 11 June 2016 as per directions of BIS authorities and restarted production on 28 July 2016. The failure on the part of the Company to get approval from the BIS authorities for the use of OPC, which was a deviation from the approved manufacturing process, was not justifiable. Stoppage of factory operations for 45 days resulted in production loss of 27,000 MT of cement at the rate of 600 MT per day. The contribution loss due to stoppage of production worked out to ₹0.64 crore¹⁵.

The Company replied that it did not intend to change the approved manufacturing process as per BIS standard. The use of OPC instead of clinker was less than five *per cent* and cement conformed to all requirements of BIS standards.

GoK replied (November 2017) that inter-grinding of OPC purchased from CCIL was resorted to as a one-time measure to mitigate likely losses to Company. Stoppage of production occurred due to minor procedural variation arising out of contingency. The reply of Company/GoK was not acceptable as there was a deviation from approved production process, which resulted in stoppage of production. Prior approval should have been obtained from BIS for the deviation from approved production process. Failure of the Company to do the same led to forced stoppage of production and the resultant contribution loss.

¹⁴ A silo is a structure for storing bulk materials like clinker, cement, etc.

¹⁵ Considering the contribution of ₹235.74 per MT achieved during 2016-17.

Conclusion

The Company did not align its purchase policies and procedures in tune with revised Stores Purchase Manual (SPM)/Government Orders and fix any time frame for procurement process. The Company did not comply with SPM provisions relating to e-tender, fixation of validity of tender, splitting of purchase orders, collection of EMD and liquidated damages and inclusion of risk and cost clause in the POs issued. Procurement of coal without exercising quality checks resulted in extra expenditure and non-compliance to BIS Standards in production resulted in production loss.

It is recommended that GoK may also review the provisions of SPM, given the instances of non-compliance to the provisions of SPM, as brought out in paragraphs 4.1.5, 4.1.6, 4.1.7, 4.1.9 and 4.1.10, if required.

The Kerala State Civil Supplies Corporation Limited

4.2 Centralised purchase of essential commodities

Introduction

4.2.1 The Kerala State Civil Supplies Corporation Limited (Company) was incorporated (June 1974) with the objective of procurement and retailing of essential commodities. The Company procures commodities centrally and sells 13 commodities¹⁶ at subsidised rates fixed by Government of Kerala (GoK) with quantity restriction and 13 commodities¹⁷ at non-subsidised prices, through its 56 depots and more than 1,500 outlets falling under five regional offices¹⁸.

The Company floats monthly e-tenders through www.tenderwizard.com¹⁹, an e-tendering website, for procurement of above commodities²⁰ centrally for all 56 depots. The Company uses a Least Cost Solution (LCS) software into which price as well as quantities offered by bidders in the e-tender are fed. LCS generates a purchase plan which gives the list of lowest bidders (L1) for each depot to meet their quantity requirement while keeping the overall purchase cost to the minimum. Head Office Management Committee consisting of functional heads of major departments of the Company finalises the purchase plan. Based on the purchase plan, Purchase Orders (POs) are issued separately for each commodity for supply at various depots. Purchase Manual 2005 and Purchase Policy 2010 approved by GoK govern the procurement process of the Company.

¹⁶ Bengal gram bold, black gram washed whole, chillies, coconut oil, coriander, green gram, jaya rice, kuruva rice, lobia, matta rice, raw rice, sugar and toor dhal.

¹⁷ Bodhana rice, cumin seed, green peas, methi, mustard, peas dhal, ragi, red piriyan chilly, split green gram, toor dhal fatka quality, black gram split, white gram and black gram dal (washed).

¹⁸ Regional offices at Thiruvananthapuram, Kottayam, Ernakulam, Palakkad and Kozhikode.

¹⁹ E-tendering solution provided by Karnataka State Electronics Development Corporation Limited.

²⁰ Except coconut oil as the Company procures and sells coconut oil under its own brand name 'Sabari'.

During 2014-15 to 2016-17, the Company floated 48 e-tenders. Since the aggregate demand of the depots could not normally be met by a single supplier, more than one PO had to be issued for a single commodity. The Company issued 4,842 POs valued at ₹3,836.80 crore for procurement of various commodities. In order to assess economy in centralised procurement of essential commodities and compliance with applicable manuals, rules and procedures, Audit selected 2,624 POs valuing ₹3,091.98 crore (80.59 per cent of total purchase order value) covering eight subsidised commodities²¹ as shown in **Table 4.4** :

Table 4.4: Details of sample selection

Year	No. of Tenders (Nos.)	Total			Sample selection			Percentage of selection
		Items (Nos.)	POs (Nos.)	Value (₹ crore)	Items (Nos.)	POs (Nos.)	Value (₹ crore)	
2014-15	15	25	1,669	1,133.72	8	881	930.47	82.07
2015-16	16	25	1,526	1,127.41	8	815	910.66	80.77
2016-17	17	26	1,647	1,575.67	8	928	1,250.85	79.39
Total	48		4,842	3,836.80		2,624	3,091.98	80.59

Audit findings

4.2.2 Audit findings are discussed in succeeding paragraphs.

Finalisation of tenders

Evaluation of bids which were ineligible due to non-furnishing of Earnest Money Deposit

4.2.3 As per the Purchase Manual of the Company and the tender conditions, each bidder must remit Earnest Money Deposit (EMD) at specified rate²² for each of the commodity bid for. Collection of EMD was aimed at preventing non-serious or frivolous bids and was to be forfeited if the bidders withdrew offer, modified the terms and conditions in any manner or did not furnish the security deposit after awarding the tender. EMD can be remitted either by way of Demand Draft issued by a Scheduled Bank or through Electronic Transfer to the accounts of the Company. Bids not supported by EMD would be invalid unless exempted. The Company followed a system of retaining the EMD after e-tender on permanent basis unless the vendor requested for refund.

Though it was mandatory for the suppliers to enter the details of EMD in the tender documents, many bidders failed to comply with the tender condition. The e-tender solution of the Company also did not enable automatic detection of status of remittance of EMD by bidders before opening bids. Due to this limitation of e-tender solution, the status of EMD was being watched through manual registers. Audit, however, observed that due to lack of system/control,

²¹ Black gram washed whole, chillies, green gram, jaya rice, kuruva rice, matta rice, sugar and toor dhal.

²² Amount of EMD of various commodities ranged from ₹5,000 to ₹1,00,000.

bids unaccompanied by EMD were reaching the stages of bid evaluation and getting purchase orders as is evident from the following instances.

- EMD remitted by Anitha Modern Rice Mill on 09 June 2015 for supply of matta rice was forfeited by the Company in April 2016 for violation of tender condition in one of the e-tenders. Despite this, the bids of Anitha Modern Rice Mill were opened and purchase orders issued against three²³ other tenders even though the bids were submitted without required EMD of ₹1 lakh each.
- Though Global Trade Corporation, another supplier, did not submit required EMD of ₹1 lakh each against two tenders²⁴ for green gram, the Company evaluated the bids submitted by the supplier and placed purchase order for the supply of green gram.
- The EMD remitted (May 2016) by Khadeeja Agencies in one e-tender²⁵ for supply of black gram washed (whole) was forfeited by the Company for violation of tender conditions. However, the supplier participated in another e-tender²⁶ floated in July 2016 without submitting EMD of ₹1 lakh and the bid was evaluated along with other bidders.

GoK replied (February 2018) that the instances pointed out by Audit were exceptions which happened due to clerical errors. GoK also stated that attempts to modify the software for automatic verification of EMD through the software providers was unsuccessful.

The reply was not acceptable as the cases pointed out by Audit highlighted the deficiencies of the existing manual system of EMD verification of the Company and reinforced the need for a software enabled system to guard against the recurrence of such lapses.

Procurement through negotiation with bidders other than L1

4.2.4 According to the provisions of Stores Purchase Manual (SPM) of GoK and guidelines²⁷ issued by Central Vigilance Commission (CVC), negotiations for public procurement can be conducted only in exceptional circumstances and that too with L1 bidders. Purchase Manual of the Company also provided that negotiations should be conducted only with L1 bidders.

Audit, however, observed that:

- The purchase plan prepared through Least Cost Solution gave the list of L1 bidders for each depot. Despite this, the Company conducted post tender negotiations in 215 instances out of a total 308 purchase

²³ Tender Nos. P10-19147-16 (August 2016), P10-31446-16 (January 2017) and P10-31446-16-Retender (January 2017).

²⁴ Tender Nos. P10-6801-16 (April 2016) and P10-26230-16 (November 2016).

²⁵ e-tender number P10-9309-16 floated in May 2016.

²⁶ e-tender number P10-15265-16.

²⁷ Circulars dated 03 March 2007 and 20 January 2010.

decisions²⁸ (70 per cent) indicating that post tender negotiations were routine and not an exception. Moreover, during negotiations, the Company allowed L1 bidder in a depot to quote for other depots including those for which the supplier did not quote originally. This led to exclusion of original L1 bidders. Analysis of 215 negotiations revealed that the number of L1 suppliers in the purchase plan came down from 12 to 8 on an average after each negotiation, indicating ouster of four L1 suppliers after negotiations. Instances of replacement of L1 bidders by other bidders in Thiruvananthapuram depot²⁹ along with the L1 rate and corresponding post negotiation rate is given in *Appendix 12*. Audit also observed that two bidders were not L1 in any of the depots while others were L1 in other depots.

- Due to expulsion of original L1 bidders after negotiations, other bidders were able to increase the quantity and number of depots up to 59 times and 44 depots respectively. The total value of additional purchase orders received by 50 suppliers who bagged maximum quantity in a tender amounted to ₹297.37 crore.
- Similarly, based on the decision (March 2010) of the Board of Directors, the Company conducted negotiations with all the participants in 24 tenders³⁰. Based on these negotiations, 18 suppliers bagged purchase orders worth ₹21.70 crore even though they were not L1 in any of the 56 depots. Details of purchase orders bagged by these suppliers were as given in *Appendix 13*. Audit observed that the above decision of the Board was against the Purchase Manual of the Company and directions of CVC and resulted in undue benefit to these suppliers. Deviation from the Purchase Manual did not have the approval of GoK.

Above methods of negotiation followed by the Company resulted in expulsion of 897 original L1 bidders in 184 cases.

Thus, the existing mode of negotiation adopted by the Company undermined the cornerstone of e-tender mechanism namely, secrecy of bids since negotiations were conducted with the bidders after open publication of initial bids. Thus, there was the risk of bidders holding back their best rates, waiting for negotiations, assessing the competitor's rates and capturing major share of purchase orders through marginal reduction in offer rates.

GoK replied (February 2018) that e-tender was conducted for meeting the requirements of the Company as a whole and hence, negotiation with all the suppliers and consequent change in L1 supplier in depots was not a violation of the approved procedures. GoK further stated that negotiations were carried

²⁸ Purchase decision is a decision to purchase one of the many commodities in an e-tender.

²⁹ One e-tender of the Company involves procuring for 56 depots. Hence, for the benefit of readability instances are limited to one depot.

³⁰ P10-31511-14, P10-35267-14, P10-5375-15, P10-10124-15, P10-17269-15, P10-19559-15, P10-23168-15, P10-25784-15, P10-27566-15, P10-33310-15, P10-1594-16, P10-6801-16, P10-9309-16, P10-12060-16, P10-15265-16, P10-17463-16, P10-19147-16, P10-26230-16, P10-26230-16-Retender, P10-31446-16, P10-31446-16-Retender, P10-1982-17, P10-1982-17-Retender and P10-5810-17.

out only in exceptional circumstances and the method of negotiation was as per approved purchase policy.

The reply was not acceptable because the system of negotiation compromised secrecy of bids and resulted in elimination of L1 bidders. The contention that the method of negotiation was as per approved Purchase Policy was factually incorrect because the Purchase Policy, 2010 was silent on post tender negotiations. Further, the Purchase Manual 2005 and the guidelines of Central Vigilance Commission authorised negotiations only with L1 bidder that too in exceptional cases. Negotiations were also pervasive rather than an exception since it was resorted to in finalising 70 *per cent* of the selected tenders. Thus, the action of the Company in negotiating with bidders other than L1 needs to be investigated, followed by appropriate remedial measures to guard against repetition of such practices.

Non-formation of Vendor Development Cell

4.2.5 Paragraph 3.1.1 of the Purchase Manual of the Company stipulated maintenance of a pre-qualified vendor list by the Purchase Department. Paragraph 3.1.2 and Annexure III B of the Manual called for formation of a Vendor Development Cell, headed by the Managing Director. This Cell was to be set up for continuous updation of the pre-qualified vendor list and also for regular monitoring of vendor performance. This Cell was also to disseminate information about requirements of the Company among major suppliers and liaise with Civil Supplies Corporations of other states in order to encourage them and their vendors to participate in the tenders floated by the Company. Audit, however, observed that such a dedicated cell was not in existence during the audit period.

In the absence of a Vendor Development Cell, there was no systematic effort to widen the vendor base as envisaged in the purchase policy. GoK replied that action for formation of a vendor development cell was initiated.

Economy in procurement

Non-diversification of supply sources

4.2.6 According to the guiding principles of Purchase Manual, the Company should avoid commission agents, middlemen, monopolies, cartel of suppliers, *benami* tenderers, *etc.*, while procuring commodities. Further, as per Purchase Policy, 2010, the Company was to consider rates from all possible sources of supply, like, commodity exchanges, regional markets and producing centres (*mandies*) in order to ensure that the purchases were made at the least possible cost. To ensure fairness, such rates had to be evaluated through Least Cost Solution so as to ensure objectivity in selection. In accordance with the Purchase Policy, the Company had been deputing its officials to *mandi* markets to collect offers and terms from suppliers up to the year 2012. After obtaining rates from *mandies*, *etc.*, the Company compared these offers with the e-tender rates and placed orders on the suppliers at *mandies* whenever their rates were lowest.

In June 2012, GoK directed that all purchases having value above ₹25 lakh by Government agencies should be finalised only through e-tender. Citing the above order, the Company stopped collecting competitive rates from suppliers at *mandies*.

Audit observed that:

- Four suppliers supplied 24.21 *per cent* value of purchases made by the Company during 2015-16. Audit test checked purchases and sales transactions³¹ of these vendors³². The audit analysis revealed that two vendors³³ who had supplied green gram and chillies against six purchase orders³⁴ sourced the items from outside the State and charged trade margins ranging from 3.20 *per cent* to 5.77 *per cent* while supplying to the Company. Involvement of these intermediaries in the above transactions resulted in extra expenditure of ₹49.94 lakh to the Company (worked out based on the trade margins mentioned).

GoK stated (October 2016) that five *per cent* margin charged by suppliers was not on the higher side considering the terms of supply like security deposit, guarantee of three months on supplies and payment terms.

The fact, however, remains that the Company could have saved this margin (₹49.94 lakh) by avoiding intermediaries to the extent possible.

- Three subsidised commodities namely, chillies, black gram bold and *toor dhal* suffered maximum price escalation during 2014-15 to 2016-17. Analysis of average purchase price of these commodities with rates³⁵ in *mandi* markets like Guntur (Andhra Pradesh) and Gulbarga (Karnataka) after considering transportation and other costs revealed that procurement cost of the Company was higher than the *mandi* rates by ₹25.67 crore.

Thus, failure of the Company to follow the guiding principles of Purchase Manual regarding avoidance of commission agents, middlemen, *etc.*, and non-consideration of rates from all possible sources including *mandi* rates was resulting in uneconomical procurement of centralised commodities.

GoK replied (February 2018) that a detailed proposal for direct procurement from production centres was under its consideration.

Deficiency in evaluation of offer rates through Least Cost Solution

4.2.7 As per Purchase Policy, 2010, local market wholesale rates collected through Regional Managers were to be evaluated through Least Cost Solution (LCS) before purchase orders were placed on the local wholesale dealers.

³¹ Using data sourced from Sales Tax Department.

³² Hafsar Trading Company, Karthika Trading Company, Sampoorna Traders and Sri Vigneswara Traders.

³³ Hafsar Trading Company and Sampoorna Traders.

³⁴ Purchase orders No.16990, 17790, 17937, 17976, 18192 and 18149.

³⁵ Sourced from www.agmarknet.gov.in.

Evaluation through LCS ensured that the GoK directive (June 2012) to procure all items with value above ₹25 lakh only through e-tender was complied with.

Review of e-tenders during the period 2014-15 to 2016-17 revealed that the Company gave permission to various Regional Managers to purchase subsidised commodities locally³⁶ based on offers sourced from the respective regions without evaluating them through LCS, as detailed in **Table 4.5**:

Table 4.5: Details of local purchases

Sl. No.	Tender No.	Item purchased	Region/depot which were allowed to purchase locally
1	P10-2795-15	Toor dhal	Thiruvananthapuram and Kozhikode
2	P10-11395-15	Chillies	Thiruvananthapuram
3	P10-14148-15	Toor dhal	Palakkad
4	P10-19559-15	Black gram Washed (Whole)	Kottayam
5	P10-28650-15	Chillies	Kozhikode
6	P10-7367-15	Raw Rice	Thiruvananthapuram

(Source: Minutes of Head Office Management Committee)

Audit also observed that in three (serial numbers 4, 5 and 6 of **Table 4.5**) out of above six tenders, the quotes from Regional Offices were received after opening of e-tender.

GoK replied (February 2018) that the rates offered by Regional Managers were considered along with the e-tender evaluation and the Regional Managers were given necessary sanction to purchase when the offered rate was lower than the e-tender rate. The reply was not acceptable because in the above cases, the rates offered were not evaluated along with the e-tender rates. Acceptance of offers after opening of e-tenders led to bypassing of the system and all the controls it was meant to introduce.

Short-procurement of commodities

4.2.8 Purchase Policy, 2010 required the stock level at depots to be always maintained between a minimum of 15 days and a maximum of 55 days so that there was neither shortage nor excess of stock. Accordingly, the indenting system of the Company was so designed that the above stock levels could consistently be maintained at depots if procurement was made as per indents raised by them.

Audit, however, observed that during the period 2014-15 to 2016-17, the total quantity purchased was only 70 per cent to 94 per cent of the total indented quantity as shown in **Table 4.6**:

³⁶Purchase Policy recommended this mode of local purchase as a means of breaking any formation of cartel.

Table 4.6: Total quantity purchased against the total indented quantity
Quantity in quintals

Sl. No.	Commodity	Indented quantity	Purchased Quantity	Percentage of indented quantity purchased
1	Black gram	6,03,286	4,41,162	73
2	Chillies	2,46,382	2,06,359	84
3	Green gram	4,38,365	3,71,203	85
4	Jaya rice	20,28,140	15,00,665	74
5	Kuruva rice	10,61,621	9,37,028	88
6	Matta rice	13,47,580	10,90,113	81
7	Sugar	30,99,236	29,11,517	94
8	Toor dhal	3,51,171	2,46,722	70

(Source: Minutes of Head Office Management Committee and purchase orders)

Analysis of stock registers maintained in eight depots³⁷ also revealed that the stock level in these depots fell below the prescribed 15 days stock level in 45 per cent to 67 per cent of the days during the period 2014-15 to 2016-17. Due to non-maintenance of prescribed stock levels, eight selected commodities other than sugar were out of stock³⁸ on an average of 5 per cent to 16.82 per cent of the days in selected eight depots. The stock out days ranged up to 55 days at a stretch, as given in the **Table 4.7**:

Table 4.7: Details of stock level position in eight selected depots during the period 2014-15 to 2016-17

Sl. No.	Commodity	Stock level position		Stock-out position	
		Average number of days below prescribed stock level	Percentage of days below prescribed stock level	Average number of stock out days	Percentage of average number of stock out days
1	Black gram	623	57	130	11.82
2	Chillies	569	52	129	11.74
3	Green gram	491	45	72	6.57
4	Jaya rice	734	67	55	5.00
5	Kuruva rice	708	65	76	6.91
6	Matta rice	654	60	162	14.80
7	Sugar	712	65	37	3.40
8	Toor dhal	554	51	184	16.82

(Source: Stock registers of the Company)

It was observed that many of these stock out periods overlapped times of highest price rise of essential commodities³⁹, which was exactly when the Company was expected to intervene in the market to stabilise the market prices.

The Company did not maintain sustained levels of stock at prescribed levels due to financial constraints brought about by non-revision of subsidy prices as detailed below:

³⁷Cherthala, Ernakulam, Kochi, Kozhikode, Perinthalmanna, Punalur, Vadakara and Wadakkancheri.³⁸Quantity less than one bag is considered as stock out in depots.³⁹Pulses and chillies.

- As per orders issued by GoK (August 2013) regarding Market Intervention Operations (MIO), price of subsidised commodities were to be fixed at 20 per cent below market price or procurement cost, whichever was lower. The reimbursement of MIO loss was also to be limited to lower of net loss of the Company as per the audited financial statements and actual MIO loss.
- GoK refixed price of six subsidised commodities (except sugar and matta rice) in November 2014 and the price of sugar and matta rice in July 2015 at rates, which were lower than the ones at which these should have been fixed as per MIO norms prescribed in August 2013. This price mismatch continued in the subsequent years 2015-16 and 2016-17 as well and in case of commodities like pulses, the difference was substantial as shown in **Table 4.8:**

Table 4.8: Details showing gap between procurement cost and subsidy prices

(₹ per Kg)

Sl. No	Commodity	2014-15		2015-16		2016-17	
		Weighted average procurement cost	Subsidy price as of March 2015	Weighted average procurement cost	Subsidy price as of March 2016	Weighted average procurement cost	Subsidy price as of March 2017
1	Blackgram washed whole	69.72	66.00	116.66	66.00	108.73	66.00
2	Chillies	75.74	75.00	109.41	75.00	109.90	75.00
3	Greengram	80.92	74.00	84.11	74.00	64.36	66.00
4	Jaya rice	30.89	25.00	24.87	25.00	30.39	25.00
5	Kuruva rice	28.72	25.00	23.99	25.00	27.11	25.00
6	Matta rice	28.38	24.00	23.38	24.00	28.94	24.00
7	Sugar	30.87	22.00	27.22	22.00	38.83	22.00
8	Toor dhal	67.76	65.00	114.31	65.00	97.56	65.00

(Source: Minutes of Head Office Management Committee and Government Orders)

Despite the wide gap in procurement and selling prices, GoK did not release the MIO loss suffered by the Company in full during any of the years under audit. The amount pending reimbursement from GoK for the previous three-year period towards MIO loss stood at ₹569.59 crore (as of March 2017). GoK also did not accede to requests of the Company to periodically re-fix the selling rate of subsidy items as stipulated in the Government Order of August 2013.

Thus, gap between purchase and selling price of essential commodities coupled with partial reimbursement of loss by GoK was the major reason for procurement of lesser quantity of commodities against the indented requirements submitted by depots leading to low/nil stock levels.

GoK agreed (October 2016) with the audit observation that the entire claim of the Company was not reimbursed and stated that the financial position and profit/ loss implication with regard to sales of subsidy commodities were also

considered by the Company while taking purchase decision. The fact, however, remains that the financial position of the Company did not allow it to maintain required minimum level of stock. Consequent stock out situations, thus, undermined the purpose of market intervention.

Deficiencies in quality control mechanism

Non-adherence to prescribed procedures

4.2.9 Quality Manual of the Company envisaged a seven-tier system of quality checks. In this mechanism, the second tier consisting of Depot Manager (DM) and the Stock Custodian had the primary responsibility to accept or reject commodities based on quality, packing and labelling. The Quality Assurance Committee (QAC) comprising of DM, Junior Manager (Marketing) and Junior Manager (Quality Assurance) formed the third tier and was to be convened whenever the DM had any doubt in quality of supplied goods. These depot level checks consisted of evaluation of physical properties of the commodity through visual judgement and use of physical tools like sieves to test parameters like damaged/immature grains, inorganic foreign matter, size, *etc.* All the goods supplied were to compulsorily pass the quality control check by either or both of second and third tier quality control mechanism. The other five tiers of quality control mechanism essentially acted as a counter checking mechanism to ensure strict implementation of the prescribed quality checks in second and third tiers.

Six samples of five varieties⁴⁰ of commodities from one depot and four outlets⁴¹ were collected by the officials of the Company at the instance of Audit. These samples were thereafter analysed through an independent external agency⁴² with respect to specifications approved by the Company and also those prescribed by Food Safety and Standards Authority of India. Test results of three out of six samples revealed that varietal admixture, total sound grains and size of grains deviated negatively from the permissible limits set by the Company. Since these commodities passed quality checks and were ready to be sold to consumers, the test results pointed to the fact that the seven tier mechanism was ineffective.

Audit observed the following deficiencies in implementation of the quality control procedures, including the seven tier quality assurance system:

- Employees of the Company formed the first tier of quality assurance. They were entitled to purchase unlimited quantities of subsidised commodities from Company's outlets on the expectation that they would give unbiased and timely feedback on quality. However, there was no system or norm for collecting feedback from the employees who purchased subsidised commodities.

⁴⁰ Black Gram (washed whole), Bengal gram Bold, Matta Rice, Toor Dal and Lobia.

⁴¹ Kochi depot and four outlets at Chullickal, Cheruvannur, Panambukadu and Paruthippara.

⁴² Council for Food Research and Development, Konni.

- Retailers' Quality Watch Committee, the fourth tier Quality Control Mechanism, was non-functional.
- The requirements regarding inspection by senior officers of the Company with special emphasis on quality⁴³ was not being watched and followed up by the Quality Assurance Wing at the Head Office.

GoK stated that action was being taken to rectify the existing lacunae in various tiers of the quality control mechanism.

Traceability

4.2.10 A key tenet in assuring quality is the traceability of commodities sold. Traceability refers to identification of the channel of procurement including details like the source, date of receipt and related Purchase Order. Traceability of goods is important to identify the source of procurement in case quality issues were noticed at the customer level. To achieve this objective, Chapter 14 of the Quality Manual prescribed that when the food items were repacked at the outlet, the packing slip should include the name of the supplier also to ensure traceability of origin.

Test check conducted by Audit at Kochi and Kozhikode depots and the outlets under them, however, revealed that the traceability of items was lost immediately on their issue to the outlets from the depots. This was happening because of the fact that as per present procedures followed by depots, goods accepted under different Goods Receipt Sheets (GRS)/ different suppliers were being forwarded to the outlets under a single common Goods Issue Sheet⁴⁴ and thus, the supplier details included in GRS were getting lost. Thus, the requirement in the Quality Manual as to inclusion of name of supplier in the packing slip when the commodities are repacked at the outlets could not be complied with.

The above-mentioned deficiency can be addressed by making it compulsory (through suitable amendment in the Quality Manual) to mark the respective GRS number on the gunny bags before they are issued to the outlets and noting the same in the packing slip when they are repacked in the outlets.

GoK replied (February 2018) that the suggestion of Audit was being considered for inclusion in the Quality Manual.

Internal control

4.2.11 Following observations are made in respect of internal control over e-tendering process:

- Tender Wizard, the online software used by the Company for e-tendering purposes delivered only the rates and quantity offered for various depots of the Company and Least Cost Solution, developed in-

⁴³ As per Circular No.28/2008 dated 19 November 2008.

⁴⁴ Used for issue to the outlets.

house was used to carry out the complex analysis of this data and prepare the best possible purchase plan.

As per best practices prescribed by CVC (September 2009) in respect of e-tendering solutions, sensitive data should be encrypted prior to transmission to other components to ensure security in data storage and communication. Audit observed that Tender Wizard and Least Cost Solution (LCS) were standalone systems and e-tender data was being manually extracted from Tender Wizard and fed into LCS without any such encryption.

- The Purchase Manual of the Company envisaged preparation of an e-tender manual specifying the procedures to be followed during the e-tendering process. However, the manual was yet to be prepared (November 2017).
- BoD decided (4 July 2014) to conduct third party certification of the e-tender procedure to ensure that there were no inherent vulnerabilities in the process. The decision was yet to be implemented (November 2017).

GoK stated (February 2018) that the existing system of e-tendering was in practice for the past twelve years and no error was reported yet. GoK also replied that detailed instructions regarding the e-tender procedure were published in the e-tender website. GoK/Company also stated that steps would be taken to implement the decision of the BoD regarding third party certification.

Audit observed that security guidelines are required to be followed even in the absence of prior history of security violations. Also, the e-tender procedures uploaded in the website were merely a set of instructions to the suppliers and did not satisfy the requirement of an e-tender manual which was meant to be an internal document guiding the e-tender process of the Company. Third party certification, along with preparation of a manual will address any vulnerability in the existing e-tendering mechanism.

Conclusion

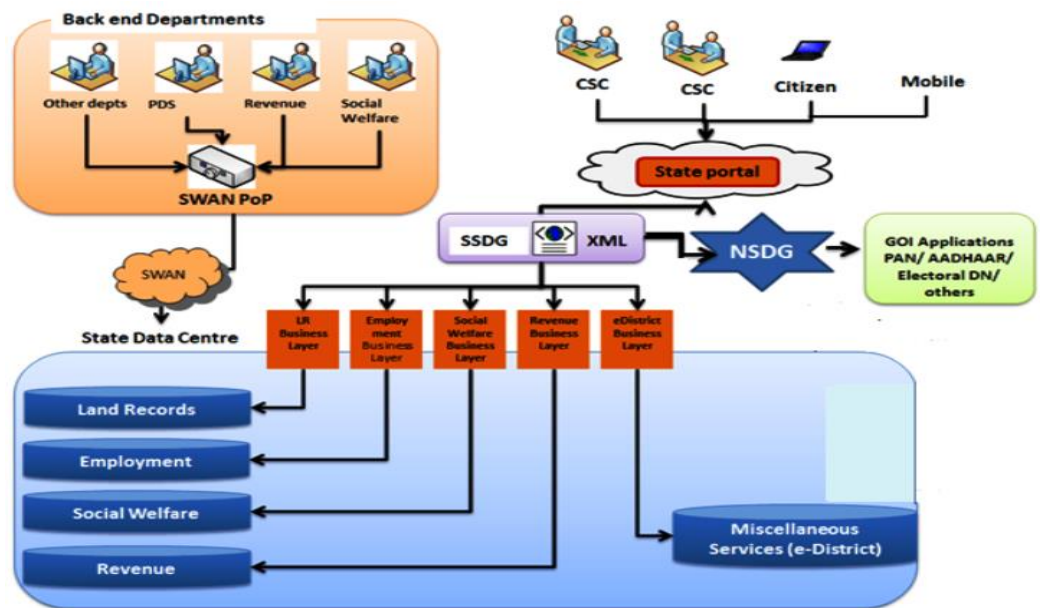
E-tendering was envisaged as a mechanism to ensure complete transparency in the procurement process, avoiding human intervention. But, the system of negotiation followed by the Company exposed it to the risk of manipulation by bidders by holding back their best rates, capturing major share of purchase orders after knowing the competitors' rates. Non-diversification of supply sources resulted in excessive dependence on intermediaries and consequent purchases at higher costs. The Company was not able to maintain optimum stock levels in depots due to restriction of purchase quantities, which even resulted in stock-out situations during times of price rise. Quality assurance mechanism of the Company also called for stronger monitoring and control.

4.3 e-Governance initiatives of Electronics and Information Technology Department, Government of Kerala

Introduction

4.3.1 Electronic governance (e-Governance) is the application of Information and Communications Technology (ICT) to the process of government functioning. The National e-Governance Plan (NeGP), introduced (May 2006) by Government of India (GoI), aimed at making all Government Services⁴⁵ accessible to the common man in his locality through common service delivery outlets. The NeGP was intended to ensure efficiency, transparency and reliability of such services at affordable costs to provide basic services to the common man. NeGP envisaged a three-tier architecture - Common Service Centres (CSC) as the first tier acting as front-end delivery points for citizen services; common and support infrastructure *viz.*, State Wide Area Networks and State Data Centre as the second tier with Mission Mode Projects⁴⁶ acting as the final tier of the architecture. e-Governance architecture can be represented graphically as given in **Chart 4.1**:

Chart 4.1: e-Governance architecture



The first Information Technology Policy of Government of Kerala (GoK), 1998 envisioned to use ICT to deliver Government services in a manner that was affordable, reliable, accessible and delivered to the citizens in a short span of time. Services were envisaged to be provided in an integrated manner to the citizens from single point of access (State portal). As part of the IT policy, GoK implemented e-Governance projects like State Information Infrastructure (SII) (which included State Data Centre), Citizen Call Centres and

⁴⁵ Example: Issue of certificates, utility payment services, services under Right to Information Act, public grievances, *etc.*

⁴⁶ A mission mode project is a project within the NeGP that focuses on one aspect of e-governance, such as banking, land records or commercial taxes *etc.* Within NeGP, "mission mode" implies that projects have clearly defined objectives, scopes, timelines and measurable outcomes.

FRIENDS⁴⁷ even before the introduction of NeGP by GoI. Thus, the State of Kerala was one of the forerunners in the implementation of e-Governance initiatives.

NeGP projects introduced by Ministry of Electronics and Information Technology, Government of India (GoI) supplemented the existing SII projects in the State. e-Governance initiative in the State has either been funded from State Plan or as Mission Mode Projects under NeGP. The revised Information Technology Policy, 2012 (IT Policy 2012)⁴⁸ also reiterated GoK's mission of using ICT for the effective, transparent and efficient delivery of services to the citizens seamlessly through an integrated e-Governance framework.

GoK designated (1999) Electronics and Information Technology Department as the authority for coordinating the e-Governance initiatives in the State. Kerala State IT Mission⁴⁹ acts as an autonomous nodal implementation Agency for the IT initiatives of the Department.

4.3.2 Audit examined three⁵⁰ infrastructure and six⁵¹ service delivery projects⁵² in the backdrop of IT Policy, 2012 in order to assess whether:

- IT projects related to e-Governance initiatives were conceptualised and implemented as per IT Policy and GoK guidelines;
- The strategies outlined in the IT Policy were implemented with economy and efficiency; and
- The envisaged levels of service delivery were achieved through e-Governance projects effectively.

4.3.3 Audit criteria derived from the following sources were adopted for the Compliance Audit:

- Information Technology Policy, 2012 of Government of Kerala;
- Relevant Acts and rules of GoK including Right to Services Act, 2012;
- Guidelines and related Government Orders issued by GoK for implementation of e-Governance projects;
- Implementation and operational guidelines issued by Government of India for NeGP projects;
- Guidelines issued by Central Vigilance Commission; and
- Stores Purchase Manual issued by GoK

Audit findings

4.3.4 The e-Governance initiatives implemented in the State resulted in enhanced service delivery and the State ranked⁵³ among the top five in the

⁴⁷ Fast Reliable Instant Efficient Network for Disbursement of Services, a single window “no Queue” integrated remittance centre.

⁴⁸ Previous IT Policies were issued in the years 1998, 2001 and 2007.

⁴⁹ A registered society.

⁵⁰ State Data Centre, State Wide Area Network and Video conferencing.

⁵¹ e-District, State Service Delivery Gateway, Citizen Call centres, e-Office, m-governance and Service Plus.

⁵² Out of a total of 32 projects.

⁵³ Source: www.etaal.gov.in

country in terms of volume of e-transactions. Audit, however, noticed the following issues in areas of planning, infrastructure creation and project implementation relating to e-Governance initiatives.

Planning and Co-ordination of e-Governance initiatives

4.3.5 The Electronics and Information Technology Department (ITD) was the designated authority for coordinating the e-Governance initiatives in the State. As a part of its role, ITD issued guidelines for implementation of e-Governance initiatives in the State in September 2009. The guidelines envisaged avoiding duplication of development of applications by different Government Departments/Agencies, non-compatibility of platforms deployed across organisations and to ensure optimum use of resources used for e-governance initiatives. With this intention, the Guidelines stipulated that the User Requirement Specification (URS), the Functional Requirement Specification (FRS) and implementation plan of all e-Governance initiatives valued at over ₹10 lakh should be approved by ITD.

Audit, however, observed that ITD did not have any comprehensive information about concurrence given on URS and FRS for all the e-Governance initiatives undertaken by various Departments/Agencies in the State. Two State Government agencies⁵⁴ (out of a total of 26 Departments approached) responded to audit enquiries that they did not take concurrence of ITD for implementation (January 2017 and March 2010) of their IT projects under 'Ease of doing Business initiatives⁵⁵' and 'Assurance Implementation Desk⁵⁶' even though their implementation cost exceeded the prescribed limit of ₹10 lakh. This indicated that e-Governance initiatives were being undertaken independently by various Departments/Agencies and ITD did not have an overall control of such implementation as envisaged in the Guidelines.

Audit also observed that though the e-Governance guidelines prohibited planning of common IT infrastructure like call centres and video conferencing facility, 10 government departments/agencies set up separate call centres/helpline as shown in **Table 4.9**:

⁵⁴ Kerala State Industries Development Corporation Limited and Department of Parliamentary Affairs.

⁵⁵ A project intended to improve ease of doing business in the State.

⁵⁶ A Web-enabled System for the monitoring of assurances made in the State Legislative Assembly.

Table 4.9: List of call centres/help lines other than Citizen Call Centre

Sl. No.	Name of the call centre/ Help line	Department/Agency	Phone number
1	Crime stopper	Kerala Police	1090
2	Comprehensive Health Insurance Agency of Kerala	Labour Department	18002002530
3	Food adulteration helpline	Kerala Commissionerate of Food Safety	18004251125
4	Toll free number for complaints	Kerala Water Authority	18004255313
5	MGNREGS Helpline	Rural Development Department	18004251004
6	Norka Roots Call Centre	NORKA Department	18004253939
7	Women helpline	Kerala Police	1091
8	Direct Intervention System for Health Awareness	National Health Mission	1056
9	Farmers call centre and Information Hub	Agriculture Department	18004251661
10	Customer care centre	Kerala State Electricity Board Limited	1912

(Source: Data furnished by IT Department)

The call centres were being operated despite specific GoK directions (June 2015) to refrain from setting up of individual call centres under any circumstances. Also, a separate video conferencing facility at an estimated cost of ₹22.25 lakh was proposed (2017) to be set up in Animal Husbandry Department. These instances pointed to the fact that expensive infrastructure was being duplicated, which was against the guidelines issued by the IT Department.

Independent e-governance initiatives without the knowledge of ITD and duplication of expensive infrastructure in deviation from the stipulated guidelines pointed to lack of co-ordination of e-Governance initiatives.

Preparedness for Disaster recovery

4.3.6 State Data Centre (SDC) is one of the core infrastructure components of e-Governance initiative and host critical data and applications of user departments. Hence, a proper Disaster Recovery and Business Continuity Plan should be put in place against any possible adverse events. Audit, however, observed the following:

a. Non- formulation of Disaster Recovery and Business Continuity Plan

As per the Guidelines for Technical and Financial Support for Establishment of SDC published by Ministry of Electronics and Information Technology, proper planning on Business Continuity⁵⁷ including Disaster Recovery should be formulated and implemented by the State. However, it was noticed that a

⁵⁷ The business continuity planning (BCP) is the creation of a strategy through the recognition of threats and risks facing an entity, with an eye to ensure that personnel and assets are protected and able to function in the event of a disaster.

Disaster Recovery and Business Continuity Plan were not formulated in accordance with the Guidelines.

b. Underutilisation of Disaster Recovery facility

The State of Kerala is provided with a reserved space of 25 Tera Byte at National Data Centre of National Informatics Centre, New Delhi as part of technical assistance provided to State for setting up SDCs under NeGP. SDC is utilising this space for disaster recovery purposes. Audit, however, observed that out of this reserved space, only 11.70 Tera Byte (less than 50 per cent) was allotted (August 2017) based on request by SDC.

Non-formulation of Disaster Recovery and Business Continuity Plan and underutilisation of the available facility indicated under preparedness against any disastrous events.

Information Technology infrastructure in the State for e-Governance Projects

4.3.7 In order to make government services available to the public, NeGP envisaged creation of various Information and Communication Technology (ICT) infrastructures like State Data Centre and State Wide Area Network as tier-II of e-Governance architecture. Audit examined the creation of such ICT infrastructures and the audit findings are discussed below:

State Data Centre

4.3.8 NeGP identified State Data Centre (SDC) as one of the core infrastructure components to consolidate services, applications and data to provide proficient electronic delivery of services. In Kerala, there are two SDCs - Old Data Centre (SDC 1), operational since the year 2005 and New State Data Centre (SDC 2), operational since the year 2011. As of July 2017, the two State Data Centres co-hosted⁵⁸ 541 websites and co-located⁵⁹ 220 servers of 44 Government Departments/Bodies/projects.

Audit reviewed various aspects of functioning of SDC 1 and 2 and observed the following issues:

Implementation of Cloud Hosting in State Data Centre

4.3.9 Cloud hosting refers to hosting of application and websites on cloud computing⁶⁰ infrastructure provided by a cloud service provider. These services provided in remotely located servers can be accessed by users on demand basis over internet. Adoption of cloud computing would enable the

⁵⁸ In co-hosting, user departments are permitted to host their websites/applications on the servers owned by SDC, by allocating a virtual space to the users in an existing server.

⁵⁹ In the case of co-location facility, SDC provides only physical space and other amenities such as power, diesel generator backup, security, etc. to the user departments for co-locating their servers, i.e., providing the physical environment for functioning of servers.

⁶⁰ Cloud computing refers to delivery of shared ICT resources over the internet which can be accessed on demand and elastically provisioned with minimal effort.

departments to increase the number of services to be offered due to on-demand availability of server space, thus, resulting in rapid elasticity.

As per the IT Policy, 2012, GoK affirmed to promote the use of cloud computing to enhance public service delivery for optimal use of resources and maximising public value. Subsequently, GoK approved (September 2013) the proposal (July 2013) of Kerala State IT Mission for enablement of cloud in SDC 2. It was envisaged that with the implementation of cloud infrastructure, additional server purchase from various departments can be reduced. Servers for cloud implementation were procured and commissioned in SDC 2 in April 2015.

Audit observed that:

- Line Departments/Agencies⁶¹ continued to procure servers for co-location even after implementation of cloud hosting in SDC 2 due to which, benefits like better utilisation of available resources, intended to be achieved through a cloud based infrastructure in SDC remained unachieved.

GoK replied (December 2017) that departments were intimated not to purchase additional servers and co-locate in SDC. GoK admitted that there were cases in which certain departments like Treasury, Taxes, Police, *etc.*, continued to co-locate servers to ensure confidentiality and to comply with regulatory requirements. Other than these special cases having concurrence of GoK, all other departments complied with the directions.

Reply of the GoK was not acceptable as Audit observed that other departments/bodies like Registration Department, Kerala Water Authority, Kerala Public Service Commission, National Rural Health Mission, Service and Payroll Administrative Repository for Kerala, *etc.*, also purchased and co-located their servers (July 2015 to June 2017) in SDC after the implementation of cloud in April 2015.

- As per provisions of Request for Proposals (RFP) for implementation of cloud in SDC 2, it was the responsibility of System Integrator who was managing SDC (Sify Technologies Limited) to ensure the backup and restore services (Warm Standby⁶²) of cloud Virtual Machines (VMs). It was also decided (December 2015) that one server from the KSITM server pool would be placed as a Backup Management server (Cold Standby) for Cloud Infrastructure, which would be added to the system only in case of any disaster.

Cloud VMs store critical data of major projects like e-Office (113 VMs), e-Health (31), Kerala Police (12), Finance Department (8), KSITM (23), *etc.* Hence, it was critical that their backups were taken periodically.

⁶¹ Revenue Department (e-District project), e-Office, Kerala Water Authority, Kerala Public Service Commission, Registration Department, Service and Payroll Administrative Repository for Kerala and Health Department.

⁶² Warm standby is a method in which data is backed up at regular intervals from the primary system.

Based on examination of monthly performance reports submitted by Sify Technologies Limited to KSITM (August 2016 to June 2017), Audit, however, observed that such a backup was not being taken. KSITM also failed to initiate any action on these reports to ensure that RFP provisions were complied with. Absence of backup increased the chances of data loss.

GoK replied that new servers and their licenses for Warm Standby were since purchased and backup was being taken. However, the detailed backup plan and latest performance reports of the Operator were not furnished to Audit for verification. GoK admitted that the Cold Standby server, which existed initially for taking backup was diverted to the production environment to accommodate more departments in cloud hosting and for meeting the increased demand for cloud storage. The reply was silent as to whether a Cold Standby was maintained at present and hence, Audit could not make any conclusion as to whether Cloud environment in SDC was adequately prepared against any disasters.

Security Audit of State Data Centres

4.3.10 As per Guidelines for Technical and Financial Support for Establishment of State Data Centre issued by MeitY, the State shall get the security of Data centres audited by third party agency once in six months and also whenever there was significant upgradation of systems which include hardware, software and network resources. Such audit shall bring out confidentiality, security and privacy of data, any apparent risks and extent to which data centre operator complied with laid down policies, standards, *etc.*

SDC 1 provided co-hosting and co-location facilities for citizen-centric and revenue generating departments like Treasury Department, Commercial Taxes Department, Kerala State Public Service Commission, several universities, *etc.* The security audit of SDC 1, conducted by CERT-K⁶³, an internal wing of KSITM reported serious vulnerabilities in December 2013. Audit, however, observed that no security audit was conducted by any third party agency in SDC 1 even though the official website of GoK (hosted in SDC 1) was defaced in January 2014.

GoK replied (December 2017) that a new tender was floated for selection of Third Party Auditor wherein audit of both SDC 1 and SDC 2 was included under the scope of work.

State Wide Area Network

4.3.11 State Wide Area Network (SWAN), a part of tier-II of e-Governance architecture, was identified as an element of the core infrastructure for supporting e-Governance initiatives under NeGP. SWAN was envisaged as the converged backbone network for data, voice and video communications

⁶³ Computer Emergency Response Team-Kerala (a security initiative of KSITM).

throughout the State with Point of Presence⁶⁴ (PoP) at State/District/Block Headquarters. Government offices in the vicinity of PoP also could be given accessibility to SWAN through Local Area Network and leased lines.

SWAN was implemented in Kerala under a Build, Own, Operate and Transfer (BOOT) contract through KSITM⁶⁵. United Telecoms Limited, Bangalore (UTL), the BOOT contractor, was selected (2006) through a tendering process and an agreement was entered into with UTL and KSITM in March 2007 for the implementation of Kerala SWAN (KSWAN). As per the agreement, UTL set up (June 2008-October 2009) PoPs at 14 District Headquarters (DHQ) and 152 Block Headquarters (BHQ). UTL was entitled for Quarterly Guaranteed Revenue (QGR)⁶⁶ during the BOOT period. As of May 2017, 3,904 offices were connected to the network using wireless radios, leased lines and Local Area Network⁶⁷.

Failure to assess reasonableness of rates

4.3.12 As per the provisions of SPM, every purchase department shall evaluate the reasonableness of the price to be paid before placing the contract. GoK awarded (January-May 2014) contract for the operation and maintenance of KSWAN project during the post BOOT period (up to June 2014) to UTL, for ₹3.44 crore. The rate was arrived at by charging 10 *per cent* interest at compound rate for 7.5 years on the rate quoted by UTL for operation and maintenance portion of the BOOT contract in 2006. Subsequently, based on the decisions taken in the KSWAN State Implementation Committee meetings from time to time, the contract period was extended every year with an increase of 10 *per cent* on the previous year's contract amount. Total contract amount for the period from June 2013 to July 2017 worked out to ₹18.87 crore. Audit, however, noticed that no effort was made by the committee to ensure reasonableness of the initial contract amount (₹3.44 crore) or the subsequent annual increases thereafter in violation of provisions in the SPM in this regard.

GoK replied (December 2017) that initially, the network envisaged only 1,660 wireless towers for horizontal connectivity to Government offices and now the connected offices were around 3,700 which were more than double the numbers. Rates were increased after taking factors like cost for annual maintenance, which was not included in the initial bid price (2006). Hence, considering the above facts, 10 *per cent* increase was found to be reasonable.

The reply of the Government was not acceptable because only 1,464 offices were connected to KSWAN using wireless towers so far. Other offices were connected using leased lines, LAN, *etc.*, for which provisions were envisaged in the district and block level PoPs as per the RFP. As such, this did not

⁶⁴ Point of Presence mainly refers to an access point that connects to and helps other devices establish a connection with the SWAN.

⁶⁵ In Kerala, SWAN was implemented as an extension of already available State Information Infrastructure from Thiruvananthapuram to Kozhikode.

⁶⁶ QGR is the guaranteed revenue that the operator shall be paid at the end of each quarter as the compensation for implementation and management of SWAN project.

⁶⁷ UTL established connectivity to 1,464 offices using wireless radios which was part of the BOOT contract. Other offices were connected to network using leased lines and LAN.

amount to additional work. Further, KSITM did not make any effort to work out the actual cost of annual maintenance to assess its impact.

Service delivery projects

Online service delivery projects

4.3.13 Online service delivery projects proposed automation of Government process work flow⁶⁸ and back-end digitisation of Government Departments for seamless online delivery of services through a dedicated portal. Citizens could access these services by submitting electronically filled up forms (web forms) either using own computers or through Citizen Service Centres. e-District and State Portal cum State Service Delivery Gateway (SSDG) Project were two major online service delivery projects implemented in the State. State-wide roll out of e-District project was completed in March 2013. Subsequently, State portal and SSDG project went live in June 2014. At present, these two projects were having separate web portals for service delivery. While e-District project was (initially) restricted to Revenue Department, State Portal cum SSDG Project intended to cover thirteen other Government Departments in the State whose services were to be delivered through a State Portal.

Audit reviewed the current state of implementation of the e-District and SSDG projects and observed the following:

Non-alignment with the Integrated Framework and single window delivery goal

4.3.14 As per the integrated framework guidelines issued (August 2012) by MeitY, all e-services were to be ultimately delivered through the single window of the State Portal. For this purpose, MeitY stipulated that services under e-District project, which were not taken up under SSDG should be integrated with SSDG so as to make them available through the State Portal. The IT Policy 2012 of GoK also declared the objective of providing a single unified portal for providing citizen services.

In line with the above, 24 certificate services under e-District project of Revenue Department were integrated and made available through the State Portal on completion of the project. Audit, however, observed that though 23 other services (**Appendix 14**) were subsequently made available through e-District portal (August 2017), they were not integrated with SSDG and made available through State Portal. This included services like Right to Information, posting of public grievances, police department payments, etc. There was also no roadmap to make these services available through State Portal and SSDG leaving the citizens to depend on multiple channels for accessing services.

⁶⁸ Various steps involved in delivery of Government service.

Alternate channels of service delivery also resulted in poor transaction count in State Portal. Since going live in 2014, the platform processed only 1,165 transactions over a period of three years (up to July 2017).

Thus, the ultimate aim of electronic service delivery through a single gateway remained unachieved and the amount of ₹6.52 crore spent on the State portal cum SSDG project remained unfruitful, considering the negligible number of transactions.

GoK stated that efforts were being made for integration of all existing services of e-District with State Portal and SSDG Project and once it became completely operational, public interface of e-District will be closed.

e-District project

4.3.15 On completion of State-wide rollout in March 2013, e-District project offered 24 certificate services of Revenue Department through the e-District portal. At present, the project was offering 47 services (*Appendix 14*). Following audit observations on the project are made:

Enhancing ease of service delivery

4.3.16 As per the guidelines for Integrated Framework for delivery of services issued (August 2012) by MeitY, States should prioritise citizen services by focusing on those services, which can be provided immediately across the counter. This was expected to enhance ease of service delivery and avoid multiple visits to the service delivery outlet. For this purpose, MeitY classified e- services into the following types:

- Type 1 services, which can be provided “instantaneously” across the counter. For delivering these services, an accurate digital database was necessary, *e.g.*, providing copy of land records.
- Type 2 services, which require minimum two visits, but can migrate to Type 1 with due data digitisation, one-time physical verification and digital certification.
- Type 3 services, which require physical presence of citizen/verification/inspection and cannot be delivered across the counter *e.g.*, issue of driving license, *etc.*

The guidelines stipulated (August 2012) identification of at least 3- 4 services, within a period of 6- 9 months, out of the e-District services, which can be provided as Type 1 services.

WIPRO Limited, the State Programme Management Unit of e-District project, conducted (2015) an Impact Assessment and Outcomes Study of e-District project. In its report, WIPRO noted that:

- Presently, the Revenue certificates cannot be issued ‘Over the Counter’ as Type 1 certificates as most of them require at least one-time field verification for its issue. So, the migration strategy recommended was to

convert the certificate services from Type 3 to Type 2 in cases of citizens applying for a certificate for the first time. With effect from the second time onwards, since the digitised database was available, the certificate may be issued 'Over the Counter'- Type 1 Certificate.

- Fifteen out of twenty three types⁶⁹ of certificates issued by the Revenue Department through e-District was valid only for the purpose stated in the certificate. Hence, they were not reusable. In order to avoid the same, WIPRO Limited recommended that validity of the certificate may be fixed for a certain tenure (minimum 6 months) or lifetime rather than for a specific purpose, wherever possible, for migration to Type 2 or Type 1 certificates.

Even though a specific migration strategy for conversion of Type 2/Type 3 to Type 1 services was recommended by the State Programme Management Unit, no service (excluding payment services) was enabled to be provided instantaneously as Type 1.

GoK replied that administrative orders were issued (March and August 2017) designating four certificates (Nativity, Domicile, Caste and Community) as general purpose and also increasing their validity period. The software was since modified for incorporating changes with respect to Caste and Community certificates. Audit, however, observed that none of the certificate was still made available as Type 1.

Low volume of services

4.3.17 The Guidelines for Integrated Framework for delivery of services issued in August 2012 stated that the measure of success of e-District project was the number of e-service transactions, which happen through the project. Accordingly, provisions of the agreement entered into (30 May 2014) with National Informatics Centre (NIC) for State-wide rollout of e-District project in Kerala stipulated that at least 10 services listed under e-District project should attain 'high volume' status of 150 transactions per month per service for the entire district.

NIC rolled out State-wide e-District project in Kerala by March 2013. As detailed in *Appendix 14*, the project offered 47 services. The number of transactions that were recorded under each category during the three-year period covered by Audit is given in **Table 4.10**:

⁶⁹ As referred to in the report of WIPRO Limited.

Table 4.10: Number of transactions in e-District project

Sl. No.	Type and No. of Service	Minimum number of transactions as per the agreement with NIC	Actual number of transactions
1	Certificates (23)	17,38,800	1,80,00,000
2	RTI Normal	50,400	126
3	RTI Appeal	50,400	18
4	Grievance	50,400	24,195
5	Revenue Court Cases (4)	2,01,600	88
6	Forest Department (6) Services	3,02,400	6,191

(Source: Data furnished by Kerala State IT Mission)

Above Table shows that except certificate services, the transactions under other categories were negligible. In this connection, Audit observed that:

- The Guidelines for National Rollout stipulated implementation of ten categories of services, of which, five categories were mandatory and the remaining were optional. Out of the mandatory services identified in the Guidelines (Certificate issue services, Social welfare schemes (like pensions, scholarships, *etc.*), Revenue Court services⁷⁰, Ration card, Grievance redressal and RTI services), Ration card and social welfare schemes were not included in the e-District project because the departments concerned had their own IT initiatives to offer such services with separate websites for service delivery. But, these excluded services were not substituted by optional services like police service, collection of taxes, *etc.*, after assessing their volume of transactions.

Further, even though RTI and Public Grievances were included in the e-District project, there was no Government Order stipulating State Government Departments to compulsorily adopt RTI services through e-District. Hence, only 5 Departments⁷¹ (out of a total of 42) voluntarily subscribed to online RTI service, leaving one of the most important public services with very low volume of adoption among the public.

Thus, due to non-adoption of high volume services and inadequate steps in popularising other existing ones, e-District portal was at present heavily dependent on certificate services to generate high transaction levels.

GoK replied (December 2017) that once a policy decision to implement an online system for RTI across all departments was taken, the same could be extended through the e-District platform without incurring additional costs except for training and awareness activities.

The reply was not acceptable as delay of GoK in taking decision hampered delivery of one of the mandatory services through the e-district platform.

⁷⁰ Services related to revenue recovery and related cases.

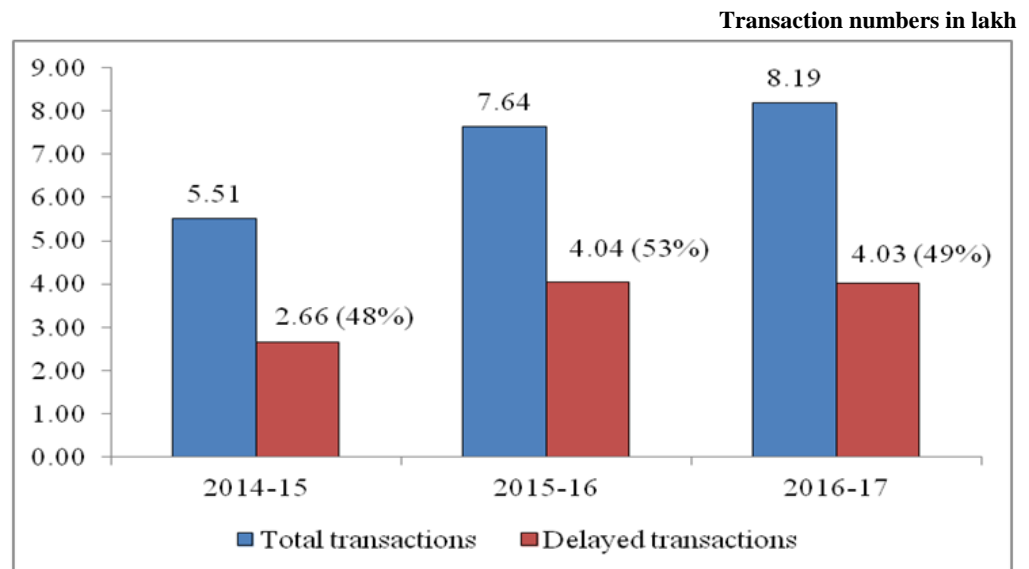
⁷¹ Technical Education, Health and Family Welfare, Higher Education, Information Technology, Non-Resident Keralites Affairs.

Non-achievement of service levels

4.3.18 Under Section 5 of the Kerala State Right to Service Act, 2012 (RSA, 2012), Government Departments are required to redress grievances of citizens and deliver services to the public in a time-bound manner. In order to comply with the RSA, 2012, departments of GoK have prescribed time-limits for delivery of various services.

Audit analysed the delivery of services in respect of 23 certificate services⁷² available in e-District. During 2014-15 to 2016-17, 1.80 crore certificates were issued through e-District. Out of this, 1.49 crore certificates were issued within the prescribed time limit, while the remaining 0.31 crore (17 per cent) certificates were delayed. In case of six certificate services⁷³, the proportion of delayed certificates was much higher as shown in **Chart 4.2**:

Chart 4.2: Number of delayed transactions in respect of six certificate services



Delays in delivery of certificate services pointed to the inadequacies in monitoring and follow up of service levels, which resulted in non-achievement of full objectives of RSA, 2012.

GoK replied (December 2017) that a comprehensive system was since introduced for monitoring e-District project performance at micro level. Accordingly, overall Service Quality (comprising of three factors, namely, reach, quantity and timeliness) for revenue certificate services (2016-17) was measured as 86.56 per cent, which showed improvement in service levels.

Reply was not tenable because timeliness did not improve in case of important certificate services.

⁷² In respect of which data was furnished to Audit.

⁷³ Community, Conversion, Domicile, Inter caste marriage, Location and Residence.

State Service Delivery Gateway Project

4.3.19 The State Portal and State Service Delivery Gateway (SSDG) project was envisaged for creating a single gateway for delivery of government services. The State Portal was meant to act as front-end interface for all State level e-Governance initiatives and to ultimately replace e-District portal. e-forms available for various Government services were envisaged to be made available to citizens through the State Portal. The filled up applications were to be routed through SSDG, a dedicated software, to the respective field offices of the Department for providing the particular service.

Audit observed following lapses in implementation of the project:

Identification and inclusion of services to be delivered through State Service Delivery Gateway

4.3.20 Ernst & Young (EY) was appointed (October 2009) as consultant for SSDG in the State for assisting in selection of an implementing agency through a Request for Proposal (RFP) tendering process. EY identified 57 services across 13 departments to be provided through the State Portal. These services included commonly availed citizen services like issue of birth certificate, encumbrance certificate, building plan approval by Local Self Governments, etc.

In IT Policy, 2012, GoK strategised to provide all services coming under Kerala State Right to Service Act, 2012 (RSA, 2012) electronically, subject to technical feasibility. GoK also notified the Kerala State Right to Services Act 2012 in August 2012. As stipulated in RSA, 2012, 47 Government Departments identified and notified about 900 services coming under their jurisdiction.

It was observed in audit that IT Department did not take any action to explore technical feasibility of adding more services to the SSDG, as of 2017. Thus, only 57 services in 13 departments, representing 6.33 *per cent* of the notified services were proposed for coverage under the SSDG project. Hence, the policy initiative of the Government to bring maximum number of services under a single portal remained unachieved.

GoK replied (December 2017) that even though SSDG covered 57 notified services under RSA, 2012, other services also can be added in a phased manner.

Audit, however, observed that no definite timeline was fixed by Government for adding the notified services under RSA, 2012 to SSDG even after expiry of five years from August 2012.

Execution of selected services

4.3.21 Tata Consultancy Services Limited (TCS) was selected (May 2012) as the lowest bidder for implementing 57 services of 13 departments under the

SSDG project at a cost of ₹13.96 crore. As per the agreement (May 2012) between TCS and KSITM, the project was to be implemented within 8 months (January 2013) followed by three years of maintenance support upto January 2016. According to provisions of RFP forming part of agreement, besides rolling out 57 services under SSDG (*Appendix 15*), TCS was to integrate 24 services delivered through e-District portal with SSDG.

However, TCS was able to integrate only 24 e-District services of Revenue Department and ten other services from five Departments. Thus, out of 81 services proposed to be covered under SSDG project, only 34 services were currently available in SSDG even though GoK spent ₹6.52 crore on the project as of February 2017.

Short completion of the project was due to the following reasons:

- MeitY, GoI while sanctioning (March 2009) SSDG and State Portal project for the State stressed on commitment of departments in execution of the project. This was to be ensured through formal agreements laying down the duties and responsibilities of each department in respect of services to be made available electronically. Co-operation of departments was required because the integration process of SSDG with departmental applications/e-District called for parting of Application Programming Interfaces⁷⁴ (APIs) by application developers of the departments concerned (major Departments had NIC as their software developer). KSITM was able to smoothly integrate e-District services with SSDG because e-District project was implemented by it through NIC. However, it could not complete such integration with other departmental applications including high volume services of Motor Vehicles Department and Local Self Government Department (LSGD) because the departments failed in ensuring that their software developers provided the required APIs.
- MeitY also suggested formation of an Apex committee headed by Chief Secretary to ensure departmental co-operation. Scrutiny of minutes of the meetings of the Apex Committee revealed that it failed in its role as a coordinating agency. For instance, in case of LSGD, even though the necessity to integrate high volume citizen-centric services⁷⁵ was taken up by the Committee in its meeting held on 16 July 2015, specific decision to direct the NIC to share the APIs of all applications developed by them was taken only in April 2017.

Thus, non-cooperation of departments and failure in effective monitoring resulted in short-completion of the project.

GoK replied (December 2017) that there was delay in implementation of the project because during the course of implementation, there was change of leadership and priorities and some of the departmental applications underwent

⁷⁴ A software that acts as an interlink between two different applications.

⁷⁵ Issue of birth and death certificates, Assessment of property tax, Application and renewal of driving license etc.

upgradation and modifications. It was also stated that some of the departments did not co-operate with the project.

Audit, however, observed that the above issues were not taken up for discussion in the Apex Committee even though it was a mechanism to ensure departmental co-operation.

Irregular payments

4.3.22 As per terms of Request for Proposal, implementation cost was payable to TCS in stages, on completion and acceptance of System Requirement Specifications (20 per cent), User Acceptance Testing (20 per cent), STQC⁷⁶ Certification (15 per cent), Go live (15 per cent) and for post commissioning maintenance for 3 years (30 per cent). Further, operational cost amounting to ₹27.56 lakh per annum was payable for three years. However, KSITM made payments (February 2014 to September 2015) to TCS on *pro rata* basis for completed number of services for the stages of User Acceptance Testing, STQC Certification and Go Live.

Audit observed that:

- As per terms of RFP, 57 services deliverable under SSDG was over and above the 24 e-District services, which were to be integrated with SSDG. Thus, total number of deliverable services was 81. However, KSITM considered the 24 e-District services as part of 57 deliverable services and made irregular *pro rata* stage payments to TCS.

KSITM also accepted the claim of TCS that the stage payments may be bifurcated into fixed (60 per cent) and variable portions (40 per cent) and the *pro rata* may be applied only on the variable portion and that the entire fixed portion may be paid in full. As there was no bifurcation of fixed and variable portions in the RFP, the payment on *pro rata* basis as per the claim of TCS was irregular.

- Despite the fact that only 34 services out of a total of 81 services⁷⁷ were made available through SSDG (including 24 e-District services), KSITM paid the entire amount of ₹27.56 lakh as maintenance charges for first year without limiting the payment on *pro rata* basis for live services.

Above considerations given to TCS were against the provisions of RFP and the agreement and resulted in extra stage payments which worked out to ₹40.17 lakh.

GoK replied (December 2017) that due to non-availability of APIs pertaining to some of the 57 services, certain services were swapped with 24 e-District services and TCS was directed to develop APIs for 24 e-District services. This was based on directions from MeitY, in a meeting held on 09 January 2014.

⁷⁶ Standardisation, Testing and Quality Certification.

⁷⁷ 24 e-District and 57 other services.

Reply was not acceptable as swapping of services was a major deviation from approved RFP and amounted to change in scope after award of work. Such a major change was done without any formal approval by Apex Committee and revised agreement. Hence, the payment effected based on such deviation was irregular. The reply regarding direction from MeitY for altering scope of work was also not supported by any documentary evidence.

Citizen Call Centre

4.3.23 Citizen Call Centre (CCC) is a single window IT enabled facility of GoK that acts as an interface between citizens and Government to interact effectively through telephone/mobile phone. Commissioned in May 2005, CCC acts as an information desk regarding Government services. Knowledge data bank of 64 Government departments/agencies are accessible by CCC. However, the existing CCC was facing the following limitations. There was:

- no toll-free number and calls were charged at local tariff;
- low awareness among the public about CCC and the services provided;
- absence of a feedback mechanism from users;
- absence of a Customer Relationship Management software;
- no automatic maintenance and tracking of complaint number and
- no intelligent handling of call details using technology.

Therefore, IT Policy, 2012 envisaged to transform the existing voice based CCC setup into a state-of-the-art Call Centre with multi modal access like phones, interactive voice response, internet, e-mail, etc.

GoK accorded (June 2015) administrative sanction amounting to ₹1.00 crore to revamp CCC. However, no bidders responded to the Request for Proposal (RFP) floated in September 2015. The project was retendered in December 2015 with modifications in the pre-qualification criteria. Three bidders participated in this tender. Tender evaluation committee, however, observed that all three bidders did not meet the pre-qualification criteria. The pre-qualification criteria were again modified before inviting another RFP in April 2017. However, no response was received for this tender also, which resulted in cancellation of RFP for the third time in a row.

Audit observed that even after two years of approval, work for revamping of CCC could not be awarded.

e-Office

4.3.24 e-Office is a mission mode project aimed at improving efficiency in Government processes and service delivery mechanism. GoK decided (August 2013) to implement e-Office in all departments in the Secretariat by entrusting the entire task of implementation with NIC and gave (October 2014) the overall project management to KSITM. Later, GoK also decided (July 2015) to implement e-Office in all the collectorates and sub-collectorates.

As per the guidelines for implementation of e-Governance initiatives issued (September 2009) by GoK, a Service Level Agreement (SLA) should be entered into with the Total Service Provider (TSP) before taking up a project. SLAs are agreements entered into with a TSP, which allows users to specify the levels of service, in terms of quantity and quality, they should receive. Audit noticed that no SLA was executed with NIC, the TSP, though the implementation started in August 2013. Due to absence of SLA with NIC, KSITM could not enforce customisation of e-Office so as to meet 10 requirements/issues raised by the customer Departments (*Appendix 16*).

GoK replied that NIC supports the Government as a partner rather than a profit oriented organisation and hence, NIC did not enter into SLAs. The Government order, which entrusted the task of implementing e-Office to NIC was considered as the initial work order. It was also stated that some of the requirements were rejected by NIC, primarily because incorporating the change would affect the generic nature of the software. NIC maintains only a single version of the software and therefore, does not undertake to address customisations that are very specific to the State.

The reply that NIC did not enter into SLAs with Government agencies was incorrect since NIC entered into agreement with GoK in May 2014 for State-wide rollout of e-District project. Further, absence of SLA was in violation of the GoK's e-Governance guidelines and best practices.

Government process re-engineering and sharing of data base

4.3.25 The e-Governance guidelines issued by the Government in 2009 specifically stipulated that the aim of e-Governance initiatives was not automation of existing processes, but included process reforms, which were technically feasible. However, audit could not find evidence of any specific effort by departments in initiating process reforms as part of e-Governance initiatives undertaken under IT Department except in case of e-District.

The Apex Committee on e-Governance in its meeting held on 24 February 2015 decided to implement Government Process Reengineering as part of e-Governance initiatives and that a Committee of Secretaries to be formed to give 25 e-Governance Process recommendations to be implemented in the year 2016-17. Except for formation of the Committee, there was no further action in this regard. The Committee also approved the decision to enable databases⁷⁸ of six departments to be shared across platforms for use by any other departments. However, no definite road map or action plan was prepared to carry forward this initiative.

During Exit Meeting, officials of KSITM pointed out that process reforms happened in Police Department and stated that sharing of database was being planned and would be implemented soon. However, the fact remains that the decision of Apex Committee in this regard was not followed up.

⁷⁸ Aadhar, Elector Photo Identity Card, SSLC certificate, Ration Card, License & Vehicle Registration and Birth & Death certificates.

Conclusion

The e-Governance initiatives implemented in the State enabled it to be ranked among the leading States in the Country in terms of volume of transactions. However, inadequacies in coordination of e-Governance initiatives of various departments/agencies by IT Department resulted in duplication of expensive infrastructure. There were deficiencies in ensuring security of data hosted by State Data Centre due to non-formulation of Disaster Recovery and Business Continuity Plans and absence of independent security audit of SDC 1. Aim of electronic service delivery through a single gateway remained unachieved as only 34 services were available through the State Portal.

Kerala State Industrial Development Corporation Limited

4.4 Failure in implementation of Enterprise Resource Planning system

Failure to provide required inputs for implementation of ERP system and to protect financial interest of the Company while entering into agreement resulted in idling of investment amounting to ₹1.39 crore.

Kerala State Industrial Development Corporation Limited (Company) decided (2009-10) to implement Enterprise Resource Planning⁷⁹ (ERP) system with the aim of automation of business processes. The Company awarded (April 2010) the consultancy work for implementation of ERP system to Network Systems & Technologies (P) Ltd. (NEST) for ₹16.05 lakh. As per the Work Order, responsibility for preparation of User Requirement Specification, preparation of contract agreement with the selected ERP implementer, overseeing the implementation of ERP system right from inception till the final delivery of ERP system, *etc.*, was vested with NEST.

The Company invited (December 2010) Expression of Interest for selection of ERP implementer⁸⁰ and selected (September 2011) CMC Limited (lowest bidder) at a cost of ₹1.40 crore with scheduled period of completion of nine months. The agreement for implementation of ERP system was executed (October 2011) between the Company and CMC Limited.

As per the agreement between the Company and CMC Limited, 13 Modules⁸¹ were to be installed by CMC Limited. CMC Limited was also to incorporate all functionalities of Finance Accounting and Loan Accounting Software in the existing IT system into the Finance and Accounts Module of the new ERP system. CMC Limited was to make the ERP system 'go live' by end of July 2013⁸². The Company was to provide all relevant information and necessary

⁷⁹ Enterprise Resource Planning (ERP) is a process by which a company manages and integrates the important parts of its business.

⁸⁰ Study, design, development, integration, testing, commissioning and maintenance of ERP system.

⁸¹ Each module is focussed on one area of business process.

⁸² Extended from the original scheduled completion time of July 2012.

administrative support for the execution of the contract. CMC Limited was to implement ERP system in accordance with the approved design documents and User Requirement Specification.

Audit observed that:

- CMC Limited prepared design documents and the same was approved by the Company by February 2013. But, the Company did not provide data in the required format for data migration from the existing IT based system to the new ERP system. Therefore, CMC Limited did not incorporate all functionalities of Finance Accounting and Loan Accounting Software in the existing IT system into the new ERP system. The Company rejected (May 2015) the modules presented by CMC Limited and consequently, the Company terminated (October 2015) the contract with CMC Limited.

Audit also observed that as per the agreement, the Company constituted a steering committee for periodic review of the progress of implementation of the ERP system. But, the steering committee did not meet even once to review the progress of implementation. Besides, NEST, the consultant, which was to review and recommend changes, if any, for the successful implementation of the ERP system, did not perform its assigned task properly.

- As per provisions of Stores Purchase Manual⁸³, the agreement was to contain risk and cost clause to ensure due performance of the contract. Agreement with CMC Limited did not, however, contain any such provision.

NEST, who was responsible for preparing contract agreement, and the Company, which was to protect its financial interest in case of failure on the part of CMC Limited failed to incorporate protective performance clauses in the agreement.

- Meanwhile, the Company procured (August 2012) computer hardware required for implementation of ERP system from CMC Limited (lowest bidder) for ₹88.48 lakh through another tender. Due to non-implementation of the ERP system, the hardware procured at ₹88.48 lakh remained idle at State Data Centre, Thiruvananthapuram.

Thus, failure to provide required input data by the Company and monitor the implementation of the ERP system by the Company and NEST coupled with absence of protective clauses in the agreement resulted in non-implementation, which led to idling of investment amounting to ₹1.39 crore⁸⁴ for five years till date (September 2017). Further, envisaged objective of automation of business processes could not be achieved.

⁸³ As per Clauses 8.17 and 8.19 of the Stores Purchase Manual (SPM) of Kerala – Revised edition 2013.

⁸⁴ Total of ₹15.39 lakh paid to NEST, ₹88.48 lakh paid to CMC for supply of computer hardware and ₹34.99 lakh paid to CMC Limited for ERP implementation.

While admitting the audit observations, GoK replied (February 2018) that they directed (December 2017) the Company to ascertain the usability of hardware acquired in connection with ERP implementation.

4.5 Loss due to undue favour to loanee

Decision of the Company to release collateral security of land resulted in non-recovery of ₹30.09 lakh.

Kerala State Industrial Development Corporation Limited (Company) acts as a facilitator and financier for promotion and development of medium and large scale units in the State. The Company offers one-time settlement facility of loan to sick units.

As per the One Time Settlement (OTS)⁸⁵ Policy, 2008 of the Company, the OTS amount shall be calculated by first determining distress value⁸⁶ of all the available securities through an approved valuer. Thereafter, interest shall be re-computed at simple interest rate from the beginning and would be added to the principal amount. From the amount so arrived at, all money received so far would be deducted to determine recomputed loan repayable (RLP). If distress value of securities is less than the RLP, the OTS amount will be the best negotiated figure between the distress value and the RLP.

The Company sanctioned (May 1999) a term loan of ₹57.50 lakh to Intech Aromatic Private Limited (IAPL). The loan was secured by first charge on primary security⁸⁷ of building and plant and machinery, created on 1.24 acres of leased land at Industrial Growth Centre (IGC), Kannur and four collateral securities⁸⁸ (four pieces of land having area of 104.11 cent⁸⁹) of the promoters of IAPL. Total value of the securities assessed at the time (1999) of sanction of loan was ₹1.10 crore⁹⁰. The loan was repayable in five years from February 2002 to November 2006⁹¹.

IAPL defaulted in repayment of principal amounting to ₹34.50 lakh⁹² and hence, the Company initiated (December 2004) revenue recovery action against IAPL. During 2008-09, IAPL became a sick unit and approached (November 2009) the Company for OTS for an amount of ₹50 lakh with down payment of 10 *per cent*. The Company approved (April 2010) the OTS proposal as distress value of available securities (₹46.70 lakh⁹³) was lower than the RLP of ₹1.08 crore. As per the OTS scheme sanctioned, IAPL made down payment of ₹5 lakh within one month (May 2010). Thereafter, the Company released three collateral securities (3 plots of land admeasuring 62.61 cents) having distress value of ₹5.59 lakh. Although the balance OTS

⁸⁵ OTS is an agreement wherein defaulting borrower agrees to pay part of the dues in order to stop lender from taking legal action against them.

⁸⁶ Distress value is the assessed value of securities held.

⁸⁷ Primary security is the asset created out of the credit facility extended to the borrower.

⁸⁸ Collateral security is any security, other than primary security.

⁸⁹ A cent is a basic unit of measurement of land and is equivalent to 40.46 square metres.

⁹⁰ Primary security was valued at its project cost of ₹1 crore and collateral securities at ₹10.16 lakh.

⁹¹ 20 quarterly instalments of ₹2,87,500.

⁹² First 12 instalments.

⁹³ Primary security - ₹38 lakh and collateral security - ₹8.70 lakh.

amount of ₹45 lakh was payable in instalments with interest within a year, IAPL failed to remit the balance amount and hence, the OTS expired in April 2011.

The Company again accepted (October 2015) the request (August 2015) of IAPL to set off outstanding dues of ₹69.38 lakh⁹⁴ against the primary security, the distress value of which was reassessed (June 2015) at ₹42 lakh. The Company also released (June 2016) the final collateral security of land having distress value of ₹24.50 lakh. Subsequent auction (December 2016) of the primary security (Plant and machinery⁹⁵) fetched only ₹7.81 lakh against the outstanding dues of ₹69.38 lakh.

Audit observed that:

- OTS policy of the Company did not provide for release of collateral security before full payment of OTS amount and setting off outstanding dues against primary security. Despite this, the Company accepted the request of IAPL and released (October 2010) three collateral securities having distress value of ₹5.59 lakh. Although IAPL did not remit the balance amount of OTS (₹69.38 lakh), the Company released (June 2016) the fourth collateral security having distress value of ₹24.50 lakh also, based on request (August 2015) of IAPL to adjust outstanding dues of ₹69.38 lakh against the primary security.
- In terms of OTS policy of the Company, IAPL was liable to remit ₹12.50 lakh (25 per cent of the OTS amount) as down payment within May 2010. Deviating from its OTS policy, the Company favoured IAPL by allowing it to make down payment of ₹5 lakh only (10 per cent of the OTS amount). Thus, there was short collection of down payment of ₹7.50 lakh.

Thus, decision of the Company to release four collateral securities of land having distress value of ₹30.09 lakh⁹⁶ resulted in non-recovery of loan to the extent of ₹30.09 lakh.

The Company replied (October 2017) that the unit was one of the first units to be set up in IGC Kannur and lack of infrastructure facilities affected the implementation of the project. The Company also replied that promoters' (IAPL) contribution amounting to ₹34.50 lakh was taken over by the Company and was hopeful of realising the dues through auction of building on the leased land.

GoK replied (November 2017) that IAPL requested the Company to release the available collateral security and to set off their entire liabilities on

⁹⁴ Unpaid OTS amount of ₹45 lakh together with interest at the rate of 10 per cent from June 2010 to October 2015.

⁹⁵ Building was not auctioned as no offer was received in three attempts.

⁹⁶ ₹5.59 lakh (distress value of three collateral securities released in October 2010) plus ₹24.50 lakh (Distress value of one collateral security released in June 2016).

surrender of the primary security to the Company and the request was accepted by the Company as a special case as no amount could be recovered from IAPL for a long time.

The replies were not acceptable as recovery of OTS amount was not dependent on provision of infrastructure in the IGC. Moreover, there was no clause in the OTS Policy for releasing the collateral securities before realising the OTS amount or to set off outstanding dues against primary security alone. Promoters' contribution of ₹34.50 lakh was taken over by the Company in the form of primary security (plant and machinery and building). The Company realised only ₹7.81 lakh on sale of plant and machinery through auction while there were no takers for the building even though three auctions were conducted for allotment of building.

The Kerala Minerals and Metals Limited

4.6 Extra expenditure in procurement of paper packing bags

Extra expenditure of ₹41.20 lakh in procurement of paper packing bags due to limiting the order quantity of the lowest bidder while simultaneously procuring at higher rates from other bidders.

According to the directions⁹⁷ of Central Vigilance Commission (CVC), the tendered quantity can be split among bidders other than the lowest bidder, only if the lowest bidder is incapable of supplying the full quantity. Items of critical or vital nature can be sourced from more than one source if the ratio of splitting is pre-disclosed in the tender itself. CVC also emphasised that conditions in the tender did not authorise tender accepting authority to take decisions in an arbitrary manner.

The Kerala Minerals and Metals Limited (Company), engaged in manufacture and sale of titanium dioxide pigment, invited (June 2014) two-part (technical and commercial parts) global e-tenders for procurement of six lakh multiwall box type⁹⁸ paper packing bags (paper bags). Three bidders submitted bids and all were technically qualified. Price bids were opened on 03 November 2014 and the standing of the three bidders were as given in **Table 4.12**:

Table 4.12: Standing of bidders on opening of the price bids

Sl. No.	Name of bidder	Landed cost per bag (₹)
1	B&A Packaging India Limited, Odisha (B&A Packaging)	36.76 (L1)
2	Dy-Pack Verpackungen Guztav Dyckerhoff GmbH, Germany (Dy-Pack)	47.19 (L2)
3	Mondi Bags Austria GmbH, Austria (Mondi Bags)	48.04 (L3)

(Source: Data collected from the Company)

⁹⁷ Circular No.4/3/2007 dated 3 March 2007.

⁹⁸ Paper bag (Valve/ Box) of size 550 mm (Length) X 470 mm (Breadth) X 135 mm (Height) suitable for use on Haver Integra Bagging Machine.

The Company placed (5 December 2014) purchase orders on B&A Packaging for one lakh paper bags at the rate of ₹36.76 per bag. Balance five lakh paper bags were procured from Dy-Pack (3.36 lakh paper bags) and Mondi Bags (1.64 lakh paper bags) at the negotiated rate of ₹45 per bag (landed cost). Decision to restrict the quantity to be purchased from B&A Packaging was taken (October 2014) by Managing Director of the Company on the ground that the firm was a new entrant and hence, was in trial stage.

Audit observed that B&A Packaging was technically qualified in the tender and hence, supply orders were not deniable on quality issues. Denial of full ordered quantity on the ground that B&A Packaging was in the trial stage was also unjustifiable because the Company procured 500 bags in December 2013 as trial and another 25,400 bags (August 2014) for bulk trial from them. Both the trials were found satisfactory (01 December 2014). Three officials of the Company also visited (14 October 2014) the factory of B&A Packaging to assess their capability and production facility and reported (18 October 2014) that it had sufficient production capacity⁹⁹. Ignoring all this, the Company restricted the quantity of order for B&A Packaging to one lakh paper bags and procured balance five lakh paper bags from Dy-Pack and Mondi Bags at higher rates, which resulted in extra expenditure of ₹41.20 lakh (5 lakh bags x ₹8.24).

Audit also observed that at the time of placing purchase orders (December 2014), the stock of paper bags was 2.43 lakh and the number of bags used per month during June 2014 to December 2014 ranged between 0.22 lakh (August 2014) and 0.74 lakh (October 2014). Thus, there was no urgency for procurement of paper bags from L2 and L3 bidders.

Government of Kerala (GoK) replied (March 2017) that the officials of the Company who visited the factory of B&A Packaging reported (18 October 2014) that looking at the technical capabilities, order of one lakh bags may be placed on the firm. Moreover, feedback from end users of the trial order of 25,400 procured from B&A Packaging was still awaited and thus, the Company was not sure about the quality of these bags. Considering the uncertainty in quality, the Company gave orders to L2 and L3 who were established manufacturers. It was further replied that the tender conditions provided for placement of orders on one or more bidders and accordingly, order for balance supply was split between L2 and L3.

Reply of GoK was not acceptable due to the following reasons:

- The officials of the Company who visited the factory of B&A Packaging reported (18 October 2014) that it had sufficient production capacity. They only suggested to give a part order to this firm and increase the quantity of order based on feedback from customers during the part supply period, which was permissible as per conditions of tender. This, in no way justified splitting of the tendered quantity among other bidders. Further, B&A Packaging quoted for supplying the entire

⁹⁹ Total production capacity of 3.50 crore bags per year and utilised capacity up to 1.8 crore bags per year as against the Company's requirement of 6 lakh bags.

tendered quantity of six lakh bags and had at no stage expressed their inability to supply the entire tendered quantity. The Company carried out the trial starting with 500 paper bags as early as December 2013 and the same was found satisfactory (29 January 2014). Further, the bulk trial of 25,400 paper bags purchased from B&A Packaging was completed in November 2014 and the Company found (1 December 2014) that the paper bags were of good quality even before placement of Purchase Order for one lakh paper bags. The Company also did not receive any complaints from the customers during the trial stage of paper bags purchased from B&A Packaging.

- Tender conditions providing for placing orders with more than one supplier simultaneously was in violation of CVC directions, as ratio of splitting quantity was not pre-disclosed in the tender documents and the item procured was not stated as critical or vital.

Thus, decision of the Company to limit the order quantity to B&A Packaging and purchase of paper bags from L2 and L3 bidders at higher rates in violation to the guidelines of CVC resulted in loss of ₹41.20 lakh to the Company.

Kerala Feeds Limited

4.7 Avoidable loss

Loss due to non-adherence to instructions of Reserve Bank of India on e-payments.

In order to facilitate quick money transfer and to avoid risk of handling huge amount of currency notes, Finance (Streamlining) Department, Government of Kerala (GoK) allowed (January 2013) Public Sector Undertakings (PSUs) to carry out individual transactions exceeding ₹2 lakh through Real Time Gross Settlement (RTGS¹⁰⁰) system. GoK also instructed all PSUs to adhere to the detailed safety instructions issued by Reserve Bank of India (RBI) on RTGS transactions. According to the guidelines issued (October 2010) by RBI on electronic fund transfer, PSUs were responsible to provide correct inputs in the payment instructions, particularly the beneficiary account number. Further, for making electronic fund transfer, PSUs should obtain mandate from customers containing sufficient information for verification of account particulars including Account Number, Name of Account Holder, Name of Bank, Name of branch, IFS Code¹⁰¹, etc. PSUs should also communicate with the parties about the details of credit that is being afforded to their account, indicating the proposed date of credit, amount and related particulars of the payment. The parties can match the entries in the passbook/account statement with the advice received by them from the PSUs.

¹⁰⁰ Real Time Gross Settlement is the continuous (real-time) settlement of funds transfers individually on an order by order basis (without netting).

¹⁰¹ The Indian Financial System Code is an alphanumeric code that facilitates electronic funds transfer in India.

Kerala Feeds Limited (Company) purchases raw material from suppliers across the country. Kaleesuwari Refinery Private Limited (KRPL), Chennai was one such supplier. Correspondence with KRPL was usually made through email and payments for raw material were made through RTGS to their bank account maintained with Axis Bank.

The Company received (23 January 2015) an email requesting to make all further payments to KRPL in a new Bank Account maintained with State Bank of India (SBI), West Marredpally Branch, Hyderabad. Based on the email, the Company transferred ₹1.38 crore between 24 January 2015 and 18 February 2015 in seven tranches to the new Bank Account from its Bank Account maintained with State Bank of Travancore, Chalakkudy Branch. On non-receipt of credits into its bank account, KRPL contacted Finance Manager of the Company on 18 February 2015. The Company informed (18 February 2015) KRPL about transfer of funds to the new Bank Account maintained with SBI. KRPL clarified (18 February 2015) the Company that the new account number was not related to them and the email address through which the change of account number was informed, was not their email address. On subsequent verification, the Company found that the email address through which the change of account number was informed was fake. Hence, the Company directed (18 February 2015) SBI, West Marredpally Branch to block the account number and freeze all transactions done in the said account number. The Company, thereafter, lodged (19 February 2015) complaints with Police including Superintendent of Police (cyber cell), Crime Detachment Bureau, Thrissur and requested (21 February 2015) SBI Administrative Office, Secunderabad for giving necessary directions to SBI, West Marredpally Branch to transfer the amount back to Company's account. After continuous follow up by the Company, the SBI, West Marredpally Branch returned (03 March 2015) ₹1.14 crore to the Company and the balance ₹24 lakh¹⁰² was not yet returned (December 2017) as this amount was withdrawn by some hacker.

Audit observed (November 2015) that the Company did not obtain mandates containing sufficient information for verification of account particulars including Bank Account Number, Name of Account Holder, Name of Bank, IFS Code of Bank, *etc.*, from KRPL before payments were made through RTGS. The Company did not communicate to KRPL the proposed date of credit of funds either. Further, the Company never requested for confirmation of receipt of funds from KRPL even though e-payments were made seven times. Thus, non-adherence of the Company to the safety instructions issued by RBI resulted in loss of ₹24 lakh.

The Company replied (June 2016) that they introduced (April 2015) a control mechanism in which the parties to whom electronic payments are made, are required to submit duly filled up electronic payment mandate form along with a cancelled cheque. The Company also replied that the above case was under investigation of Police (Crime Branch) and hence, they did not release the

¹⁰² Exact amount to be recovered was ₹23,89,609.

amount of ₹24 lakh to KRPL although KRPL demanded (March 2016) the said amount.

Government of Kerala replied (December 2017) that they directed all PSUs to introduce a strong internal control mechanism by ensuring the safeguards prescribed by Reserve Bank of India to avoid financial loss under electronic fund transfers.

The fact remains that due to non-adherence to instructions of RBI relating to e-payments, the Company suffered a loss of ₹24 lakh and the chances of recovery were remote.

Forest Industries (Travancore) Limited

4.8 Avoidable expenditure

Delay in filing of income tax return and non-remittance of advance tax resulted in avoidable interest liability of ₹3.26 crore.

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. Section 208 of the Act stipulates that such companies 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 234 B of the Act). Companies are to pay advance tax in a staggered manner in four quarterly instalments between June and March of the corresponding financial year (Section 211 of the Act). If any instalment is not paid or less paid, interest is chargeable on the shortfall amount, under Section 234 C of the Act.

Besides payment of advance tax, companies are required to file income tax return in the prescribed form on or before the due date *i.e.*, 30th day of September of the assessment year. 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).

Forest Industries (Travancore) Limited, (Company), engaged in the business of manufacturing wooden furniture/joineries and civil construction, had taxable income ranging from ₹35.76 lakh to ₹398.51 lakh during assessment years 2007-08 to 2013-14. Even though the Company had tax liability in excess of ₹10,000 during these years, the Company, did not remit advance tax in any of the years nor did it file tax returns on time. Consequently, the Income Tax (IT) department imposed penal interest of ₹3.26 crore on the Company as shown in **Table 4.13**:

Table 4.13: Statement showing details of penal interest levied

(₹ in lakh)

Assessment year	Taxable Income	Total Tax Payable	Advance Tax Payable ¹⁰³	Advance Tax Paid	Date of Filing of Return	Penal interest levied
2007-08	88.48	29.78	26.80	0	04/12/2014	58.60
2008-09	62.39	19.27	16.84	0	05/12/2014	31.98
2009-10	53.10	16.40	14.36	0	05/12/2014	22.74
2010-11	35.76	11.05	6.23	0	29/01/2015	7.75
2011-12	39.86	12.31	10.75	0	29/01/2015	10.82
2012-13	265.64	86.18	76.63	0	27/09/2016	93.79
2013-14	398.51	129.30	107.27	0	05/10/2016	100.29
Total	943.74	304.29	258.88	0		325.97

(Source: Data collected from the Company)

Out of the total tax and interest liability of ₹630.26 lakh (tax payable—₹304.29 lakh and interest liability – ₹325.97 lakh) for the assessment years 2007-08 to 2013-14, the Company paid ₹356.12 lakh as of February 2018.

Audit observed (May 2017) that there was delay in finalisation of accounts by the Company. The annual accounts of the Company were finalised (December 2015) only upto 2012-13. There were delays ranging from 11 to 34 months for finalisation of accounts for the period 2006-07 to 2012-13. Audit also noticed that the Company did not have an effective internal control system to monitor the compliance to provisions of Income Tax Act, 1961. The Company did not prepare cash budget for assessing whether the Company was having sufficient cash resources for making statutory payments. The delay in filing return and non-payment of advance tax resulted in avoidable interest liability of ₹3.26 crore.

GoK replied (February 2018) that advance tax was not paid since the cash position of the Company was not favourable and the Company was dependent on overdraft facility during the aforementioned periods. Regarding non-finalisation of accounts, it was replied that as the Company was dealing with Government department works, there was delay in getting the final work orders/bills. The final bills to Government and invoices raised by sub-contractors were finalised at a later stage after finalising measurement books and their approval by officials concerned. Thus, the Company was not able to finalise the accounts in a timely manner. It was also replied that tax audit and statutory audit were done by different firms and tax auditors could conduct tax audit only after finalisation of statutory audit.

The reply was not acceptable as payment of advance tax was a statutory requirement. As advance tax is payable only to the extent of 90 per cent by March, there is a leverage of 10 per cent to meet uncertainty associated with delay in finalisation of bills by Government. Moreover, non-finalisation of accounts led to delay in completion of statutory audit and consequent delay in tax audit. The Company also did not finalise the annual accounts for the period 2013-14 (February 2018).

¹⁰³ 90 per cent X (Tax Payable - Tax Deducted at Source).

Thus, delay in filing income tax returns and non-payment of advance tax in accordance with the provisions of the Income Tax Act, 1961 resulted in avoidable interest liability of ₹3.26 crore. Moreover, the tax liability of ₹2.74 crore for the assessment years 2007-08 to 2013-14 was yet to be paid by the Company.

Kerala Automobiles Limited

4.9 Absence of agreement leading to idling of rear engines

Absence of agreement with the support partner while transferring rear engines for conversion into three-wheelers resulted in 176 rear engines worth ₹52 lakh lying idle with the support partner.

As per Article 51 of Kerala Financial Code, contracts for the execution of works should be made as far as possible only after inviting open tenders. Further, as per Article 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.

Kerala Automobiles Limited (Company) engaged in the manufacture of three-wheelers with diesel engines, procured (March - April 2013) 335 Electric Start BS III Rear Engines for ₹98.99 lakh (unit price¹⁰⁴ of ₹29,550) from Greaves Cotton Limited, Ranipet, for manufacture of rear engine vehicles. Out of the 335 engines procured, 86 engines were utilised for manufacture of rear engine vehicles, which were sold in 2013-14. As the vehicles sold developed service complaints, the Company stopped manufacture of rear engine vehicles. As a result, the remaining 249 engines were not utilised.

Considering the financial and technical constraints faced by the Company in developing and establishing rear engine three-wheelers in the market, the Company invited (September 2014) Expression of Interest (EoI) for manufacture and supply of rear engine three-wheelers to the Company as a support partner and selected Continental Engines Limited (CEL) out of the two qualified bidders. Agreement was executed (August 2015) between CEL and the Company.

Meanwhile, the Company informed (December 2014) CEL that it had 249 Greaves-make rear engines and was willing to transfer those engines to CEL and CEL in turn should supply fully built three-wheelers fitted with those engines to the Company. As CEL agreed with the proposal, the Company decided (January 2015) to transfer the 249 engines to CEL at cost price of ₹73.58 lakh¹⁰⁵ for subsequent fitting into the vehicles supplied to the Company. The Company despatched (January/February 2015) 249 engines to CEL against a purchase order issued by CEL. Out of these, 73 engines were fitted by CEL in vehicles supplied (2016-17) by them. The remaining 176 engines valuing ₹52 lakh¹⁰⁶ were lying with CEL till date (August 2017).

¹⁰⁴ Excluding taxes and freight.

¹⁰⁵ Excluding applicable taxes and duties.

¹⁰⁶ 176 X ₹29,550.

Audit observed that the Company while inviting EoI for selection of support partner did not include the aspect of transferring 249 greaves-make rear engines, which were lying idle for fitting in the three wheelers to be supplied by them. Further, no formal written agreement specifying rate of conversion and date of completion was executed between the Company and CEL for the conversion work. Due to these lapses, 176 rear engines valuing ₹52 lakh were yet to be converted into rear engines vehicles and returned to the Company.

Audit further observed that the Hon'ble Supreme Court of India (March 2017) ordered that no manufacturer or dealer shall sell any vehicle whether two wheeler, three wheeler, four wheeler or commercial vehicles, which were not BS IV compliant¹⁰⁷ in India with effect from April 2017. Since the engines transferred to CEL were non-BS IV compliant, it would not be possible to sell vehicles fitted with these engines in India.

GoK replied (February 2018) that the transaction helped the Company for partial liquidation of engine stock and mobilisation of dead funds. GoK further stated that purchase order received from CEL may be treated as agreement between CEL and the Company for conversion of rear-engines.

The reply was not acceptable as the Company did not include the aspect of transfer of the 249 idle engines to the support partner for fitting in the three wheelers to be supplied by them while inviting EoI. Further, though the Company was aware (January 2015) about the withdrawal of BS III engines within one to two years, the Company did not include clauses for timely conversion of these engines to three wheelers in the purchase order. Moreover, the purchase order cannot be a substitute for an agreement as it did not contain conversion time, time of return of vehicles, and other such terms and conditions. Moreover, the fact remains that 176 engines worth ₹52 lakh were yet to be returned by CEL to the Company after fitting them in auto rickshaws.

Thus, due to absence of agreement with the support partner while transferring rear engines for conversion into three-wheelers, 176 rear engines worth ₹52 lakh remained idle with the support partner.

Statutory corporations

Kerala State Road Transport Corporation

4.10 Avoidable liability due to delay in collection of service tax

Delay in decision on collection of service tax from passengers of air-conditioned buses resulted in avoidable liability of ₹3.05 crore, besides penal interest of ₹61.14 lakh.

Government of India (GoI) issued (01 March 2016) a notification mandating levy of Service Tax on the service of transportation of passengers by air conditioned buses with effect from 01 June 2016. Accordingly, the service tax, being an indirect tax, shall have to be paid by passengers availing such

¹⁰⁷ Bharat Stage (BS) norms are emission control standards. The BS IV norms were introduced with effect from 01 April 2017.

services at the rate of 6 per cent¹⁰⁸. Service tax so collected by the service provider was to be paid to the Central Government on or before 5th (Offline payment)/6th (Online payment) of the succeeding month. Failure to pay service tax on or before due date would attract penal interest. Penal interest would be 24 per cent per annum if amount of service tax is collected but not credited to the Central Government on or before the due date and 15 per cent per annum in other cases.

Kerala State Road Transport Corporation (Corporation) was established (March 1965) under the Road Transport Corporation Act, 1950 to provide road transport services and other ancillary services in the State. The Corporation operated 221 air conditioned buses as of June 2016. Since service tax on transportation of passengers by air conditioned buses would become part of the ticket fare, approval of State Government was required for its implementation as per Section 19 of the Road Transport Corporation Act, 1950.

As service tax became leviable from 01 June 2016 and in order to obviate payment of interest on delayed payment of service tax, the Corporation ought to have obtained approval of Government of Kerala (GoK) sufficiently in advance for its levy through fare hike with effect from 01 June 2016. Despite this, the Corporation requested GoK only on 13 May 2016 to take a decision as to whether the service tax was to be collected from the passengers or to remit service tax from the existing revenue of the Corporation. As the Corporation did not receive directions in this regard from GoK, the Corporation did not collect service tax from passengers of air conditioned buses and did not remit the dues on account of service tax to GoI. Approval of GoK for collecting service tax from passengers was received only on 22 November 2016. The Corporation started collection and remittance of service tax with effect from 16 December 2016 only.

Audit observed that the Corporation and GoK took about nine months¹⁰⁹ for taking final decision on the subject. As a result, the Corporation did not collect service tax amounting to ₹3.05 crore from passengers who availed service of transportation on air conditioned buses during 01 June 2016 to 15 December 2016. GoI advised (April 2017) the Corporation to make payment of the service tax on the value of service provided during 01 June 2016 to 15 December 2016 along with interest. Hence, the Corporation became liable to pay service tax from its revenue along with penal interest of ₹61.14 lakh¹¹⁰. The Corporation was yet to remit the same (January 2018).

Thus, the delay in decision making at the Government/Corporation level for collection of service tax coupled with non-compliance of provisions of Finance Act resulted in avoidable liability of ₹3.05 crore and penal interest of ₹61.14 lakh.

¹⁰⁸ After abatement of 60 per cent on service tax of 15 per cent.

¹⁰⁹ About three months on the part of KSRTC and about six months on the part of GoK.

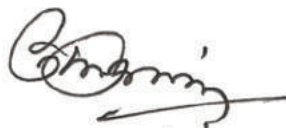
¹¹⁰ At the rate of 15 per cent per annum upto 31 January 2018.

GoK stated (April 2017) that as soon as the said notification was issued, GoI was requested for granting exemption from levying the same and since the request for exemption was not accepted by GoI, permission was given (22 November 2016) to the Corporation for collecting the service tax along with ticket fare. Accordingly, the Corporation started levying the same with effect from 16 December 2016. It was further stated that the liability accrued not because of any administrative delay on the part of the Corporation.

The reply was not acceptable as GoI issued notification on 01 March 2016 with date of effect from 01 June 2016. The Corporation should have approached GoK in time for levy of service tax from passengers of air conditioned buses. But, the Corporation requested GoK only on 13 May 2016 and GoK accorded its approval on 22 November 2016 to charge service tax.

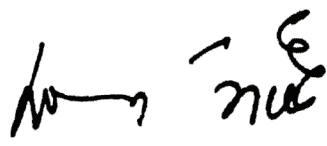
Thus, the inordinate delay on the part of the Corporation and GoK resulted in the Corporation's liability to pay service tax of ₹3.05 crore along with penal interest of ₹61.14 lakh¹¹¹ out of its own resources. The amount of penal interest would increase if the payment is further delayed by the Corporation.

Thiruvananthapuram,
The


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New Delhi,
The


(RAJIV MEHRISHI)
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¹¹¹ Up to 31 January 2018.