Chapter II

2. Performance reviews relating to Government companies

Orissa Mining Corporation Limited

2.1 Production, Inventory and Cash Management

Highlights

The Company could not achieve the targeted production of ores during 2003-08 (except 2006-07) due to the shortfall in production of iron ore by 45.59 lakh MT by the contractors resulting in loss of contribution of Rs. 350.10 crore.

(Paragraphs 2.1.7 and 2.1.9)

Increase in target of production without evolving corresponding marketing strategies led to accumulation of stock of 22.54 lakh MT valued at Rs. 71.53 crore resulting in blockage of funds of Rs. 41.59 crore.

(Paragraph 2.1.21)

The inventory management was ineffective leading to accumulation of 1.59 lakh MT of iron ore valued at Rs. 19.44 crore from one to four years.

(Paragraph 2.1.22)

Failure of the Company to install a new Chrome Ore Beneficiation Plant to process low grade chrome ore of 9.86 lakh MT to chrome concentrate deprived it and the Government of India the opportunity to earn additional revenue of Rs. 555.81 crore and Rs. 90.55 crore respectively.

(Paragraph 2.1.23)

Inaction of the Company to process/sell 52,253 MT of chrome ore resulted in non-realisation of Rs. 33.49 crore.

(Paragraph 2.1.24)

Repayment of loan in deviation from the terms and conditions resulted in extra expenditure of Rs. 22.44 crore.

(Paragraph 2.1.33)

Introduction

2.1.1 Orissa Mining Corporation Limited was incorporated (May 1956) as a wholly owned Government company with the main objective to develop and operate mines and to sell minerals in the domestic market and also export. The mining operations include removal of overburden, drilling, blasting, raising of Run Off Mines[ø] (ROM) and sizing/crushing which is done departmentally as well as through contractors. The Company mainly raises iron, chrome and manganese ores.

The affairs of the Company are managed by a Board of Directors (BoD). As on 31 March 2008, the BoD comprised of 10 Directors including one part time Chairman and the Managing Director (MD). The MD is the Chief Executive Officer assisted by three General Managers at the Head Office, seven Regional Managers at seven[¥] regional offices for mining operations and one Shipment Officer at Paradeep handling minerals meant for export sales. There were no operating mines under Rayagada regional office since 2002.

The working of the Company was last reviewed and commented in the Report of the Comptroller and Auditor General of India for the year ended 31 March 2004 (Commercial), Government of Orissa. The report is pending (September 2008) for discussion in the Committee on Public Undertakings (COPU).

Scope of audit

2.1.2 The present Performance review conducted during December 2007 to April 2008 covers the production, inventory and cash management in the Company pertaining to the five years ending 31 March 2008. Audit selected all six operating regional offices and the Shipment Office at Paradeep for detailed examination. Besides, 41 out of 58 composite contracts (includes raising, crushing and transportation of ores) entered in 2003-08 were examined.

Audit objectives

2.1.3 The Performance Audit was conducted with a view to assess whether:

- targets for raising, transportation and crushing of ores were fixed on the basis of the resources available and marketability;
- variances between targets and achievements were analysed and remedial measures taken;
- an effective inventory management system with regard to procurement, storing, utilisation and disposal was in place;

[ø] The required minerals which are extracted after getting the mine ready i.e. after removal of overburden.

[¥] Barbil, Bangur, Daitari, Gandhamardan, J.K. Road, Koira and Rayagada.

- unsaleable stock of minerals was timely utilised/disposed of;
- spare parts of different plant and equipment were properly utilised during scheduled or regular maintenance to reduce downtime of equipment/plant;
- cash management was adequate, effective and efficient; and
- an internal control system existed in respect of production, inventory and cash management and was being adhered to.

Audit criteria

2.1.4 The audit criteria adopted for assessing the achievement of the audit objectives were:

- provisions of various statutes, rules of mining, policies laid down by the State Government and the Company's business plan;
- rules and regulations of the Company for procurement of stores and spares/different types of equipment and their utilisation;
- agreements with the raising/processing/transport contractors, etc.;
- rules and regulations framed by the Company for storage and disposal of minerals, identification of idle, damaged or obsolete inventory and their disposal; and
- General Financial Rules and principles including investment policy of the Company.

Audit methodology

2.1.5 The audit methodologies adopted for achieving the audit objectives with reference to audit criteria were:

- examination of agenda notes for meetings of BoD and Audit Committee and minutes thereof, internal audit reports, annual reports, agreements for mining, transportation, etc.;
- scrutiny of records relating to production including target and achievement, monthly production, transport and sales reports;
- examination of files and registers relating to procurement, utilisation, disposal and storage of inventory stores;
- scrutiny of records pertaining to investment of surplus funds; and
- interaction with the Management.

Audit findings

The findings of the Performance Audit of the Company were reported (June 2008) to the Government/Management and also discussed (5 August 2008) in the meeting of the Audit Review Committee for State Public Sector Enterprises (ARCPSE) which was attended by the Commissioner-cum-Secretary, Steel and Mines Department of the State Government and the MD of the Company. The views of the Government/ Management have been considered while finalising the review. The audit findings are discussed in the succeeding paragraphs.

Exploitation of leasehold mines

2.1.6 The State Government had leased out total mines area of 52,651 hectares in the State, out of which the Company was given lease of 19,313 hectares (37 *per cent*) comprising of 34 mines. As on 31 March 2008, the Company was operating in 12,136 hectares (63 *per cent*) comprising 13[*] mines. It, however, could not operate eight[#] mines since the date of receipt of lease (1970 to 2002) for want of forest clearance, operation of 12[&] mines was suspended (1992 to 2008) due to requirement of forest clearance and one[$] mine was kept inoperative by the sub-lessee. During the period under review, three[∇] iron ore mines became inoperative for want of forest clearance.

Production performance

Target and achievement

2.1.7 The minerals raised by the Company mainly are iron, manganese and chrome ore. The Company fixes mine-wise targets of production of minerals based on the market demand, raising capacity and available resources. Besides, the prevailing market situation and the long-term contracts under execution were also considered for fixation of targets. The targets are fixed in the annual budget and approved by the BoD. The actual production and sale of iron, chrome and manganese ore vis-à-vis the targets for the five years upto 2007-08 are detailed in **Annexure 10**.

It would be observed from the annexure that in respect of iron and manganese ore, the target for production was on a reducing trend up to 2006-07, which was increased only in 2007-08. The target in respect of chrome ore was, however, on an increasing trend. The actual production against targets in respect of iron ore, chrome ore and manganese ore ranged between 51.38 and

[*] **Chrome ore**:Bangur, Kaliapani, South Kaliapani, Sukrangi, **Iron ore**: Balda Palsa Jajanga, Daitari, Gandhamardan-A, Gandhamardan-B, Khandabandha and **Iron & Manganese ore**: Dubuna-Sekradihi, Kolha Roida, Kurmitar, Serenda Bhadrasahi.

[#] **Chromite**: Baniapanka, Base of Mahagiri, Saruabil-Sukrangi, **Manganese**: Parlipada, Roida-78, **Gemstone**: Budhapada, Hinjilibaha and Malipada.

[&] **Chromite**: Birasal, Boula, Kalarangi, Kathpal, **Iron**: Banspani, Dalki, Koira-Bhanjapalli, Koira-kasira, Tirinpahar, Rantha, **Manganese**: Nishikhal and **Limestone**: Umpavalley.

[$] Gemstone mine at Jillinghdha.

[∇] Banspani, Koira-Bhanjapalli and Koira-Kasira.

Non-achievement of targets of production resulted in shortfall in production of iron and manganese ore by 47.01 lakh MT and 2.11 lakh MT respectively during 2003-08.

116.15 *per cent*, 83.61 and 159.48 *per cent* and 41.59 and 70.83 *per cent* respectively. The Company could not achieve the targets of production of iron and chrome ore during 2003-08 (except in 2006-07) and in case of manganese ore, the production was less than the targets in all the five years. The non-achievement of targets led to shortfall in production of 47.01 lakh MT of iron ore and 2.11 lakh MT of manganese ore.

The main reasons for shortfall in production of iron ore were attributable to consistent problem in the primary crusher of the Ore Handling Plant (OHP), non-achievement of the targets by the contractors, delay in supply of explosives and handing over of quarries, mines plans, etc. as discussed in paragraph 2.1.9. In case of manganese ore, the shortfall was attributable to restriction imposed by the statutory authorities in all the manganese mines.

Government stated (September 2008) that the shortfalls in production were due to various statutory problems like forest clearance and its effect in executing the contract. The reply is not acceptable as the targets are fixed considering all possible constraints; in fact the achievement was not satisfactory due to lapses on the part of contractors, delay in supply of explosives and delayed handing over of quarries, mines plans, etc. to the contractors by the Company.

Raising of ores

2.1.8 The Company did not furnish the records relating to target and achievement of production of ores departmentally and through contractors for the years 2003-04 and 2004-05. Audit observed that the Company produced iron ore and chrome ore mainly through the contractors. The production target of the contractors against total target fixed in respect of iron ore, chrome ore and manganese ore during 2005-06 to 2007-08 ranged between 84 and 93 *per cent*, 90 and 95 *per cent* and 29 and 65 *per cent* respectively. The achievements of the contractors for the years 2005-06 and 2007-08 in respect of iron ore and chrome ore were below the targets fixed and comprised of 75 and 91 *per cent* and 86 and 85 *per cent* respectively. Thus, the shortfalls in production of iron ore and chrome ore were 13.05 lakh MT and 3.49 lakh MT respectively in 2005-06 and 2007-08.

Production of iron and chrome ore was below the targets by 13.05 lakh MT and 3.49 lakh MT respectively in 2005-06 and 2007-08.

Some of the individual cases highlighting the shortfall in production by the contractors have been discussed in the succeeding paragraphs.

Shortfall in production of iron ore and non-levy of penalty

Despite shortfall in production by the contractors, the Company did not levy penalty of Rs. 0.94 crore.

2.1.9 The Company raises ore mainly through contractors. The agreements executed with the contractors stipulate levy of penalty for short production. Audit scrutiny revealed that even though the contractors did not raise the quantity as per the agreements, the Company did not levy penalty of Rs. 94.29 lakh on four[$] contractors as detailed in **Annexure 11.**

[$] Arun Udyog (3rd year), B. Seenaiah & Co., Pradeep Mining Construction (P) Limited and B.D. Mohata.

Further, shortfall in production by these four contractors including short production by three[*] other contractors (where penalty was not imposed) was due to fault of the Management viz. delay in installation of weighbridge, delay in preparation of ground work, inadequate/delay in deployment of machineries, repairing of ghat road, short supply of explosives, delay in handing over of the quarries, mining plan, handing over of non-proved reserves quarries, etc. Hence, during the contractual period of September 2003 to July 2007 the total production achieved by the contractors was 35.58 lakh MT against the target of 81.17 lakh MT. This resulted in loss of contribution[#] of Rs. 350.10 crore on shortfall in production of 45.59 lakh MT.

Failure of the Company in providing required facilities for production led to shortfall in production of iron ore by 45.59 lakh MT resulting in loss of contribution by Rs. 350.10 crore.

Government stated (September 2008) that due to development and restoration of mines in compliance with the Mines Act, infrastructural constraints, restriction imposed by Forest authorities, delay in handing over the quarry, short supply of explosives and inadequate deployment of men and machineries by the contractors, there were shortfalls in production for which penalty of Rs. 62.76[@] lakh had been withheld from four contractors. The reply is not acceptable as the targets are fixed considering all possible constraints. The constraints extended by the Government for shortfall in production was required to be handled effectively through proper planning and monitoring of the events. Further, the Company did not recover penalty of Rs. 94.29 lakh from four contractors despite their inability to mobilise required men and machines which led to shortfall in production.

Processing of ore

2.1.10 The ores raised from the mines are generally large sized (ROM) and unsuitable for use as raw material. Therefore, ROM is crushed into lump ore which is further crushed into Calibrated Lump Ore (CLO) and in this process iron ore fines[∇] are generated. The purpose of producing CLO is to have easy marketability and to fetch higher price. Thus, adequate and effective crushing operations play a vital role not only in achieving the production target but also in maximising the revenue of the Company. The departmental operations i.e. crushing of ores in OHP is available in Daitari only.

The deficiencies noticed in crushing activities of the Company are discussed in the following paragraphs.

Ore Handling Plant, Daitari

2.1.11 The Ore Handling Plant (OHP), commissioned in 1974, comprises of crusher, long distance conveyor belt and washing plant. The matter relating to shortfall in production in OHP due to non-replacement of the crusher had been commented vide paragraph 2.1.13 of the Report of the Comptroller and Auditor General of India for the year ended 31 March 2004 (Commercial),

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[*] Arun Udyog (1st and 2nd year) Synergex Infrastructures (P) Limited and Ares & Sons.
[#] Sale price less cost of raising and crushing.
[@] AU (Rs. 4.12 lakh), FGMPL (Rs. 35 lakh), BSC (Rs. 16.12 lakh) and PMCPL (Rs. 7.52 lakh).
[∇] Iron ore of size less than 10 mm.

Government of Orissa. It was pointed out in the paragraph that the decision of the Management for repair of the equipment instead of its replacement was not prudent in view of the fact that the need for its replacement was considered as early as in July 1995. The Company appointed a consultant for improving the performance of OHP, who recommended (June 2004) for overhauling/ replacement of OHP. The Company again appointed (September 2006) a consultant (M.N. Dastur & Co) to prepare feasibility report for installation of a new OHP. In spite of receipt (March 2007) of the report from the consultant no final action has been taken.

The following table depicts the installed capacity, targets fixed and achievement thereagainst:

Year	Installed capacity	Target	Percentage of target to installed capacity	Achievement	Shortfall	Percentage of shortfall
	(In lakh MT)			*(In lakh MT)*		
2005-06	20	5	25	4.19	0.81	16
2006-07	20	4	20	4.27	--	--
2007-08	20	3	15	3.45	--	--

Failure of the Company in replacing the OHP, resulted in potential contribution loss of Rs. 144.76 crore during 2005-08.

Thus, failure of the Company in replacing the OHP despite persistent low utilisation of installed capacity, considering 70[Ω] *per cent* utilisation of rated capacity, led to shortfall in production of 30.09 lakh MT of ore resulting in potential contribution loss of Rs. 144.76 crore during 2005-08 besides rendering the mining equipment of the Company idle as discussed in paragraph 2.1.14.

Further, as per feasibility report (March 2007) of M.N. Dastur & Co., the total project cost was Rs. 318.94 crore with a pay back period of around two years only. The funds could have been met from the Company's own resources without any extra financial charges. The cost of production (2006-07) with a new OHP worked out to Rs. 310.36 per MT whereas the cost of production with the existing OHP was Rs. 610.71 per MT. Thus, the Company incurred extra expenditure of Rs. 62.89 crore on production of 20.94 lakh MT of ore during 2003-08.

Government accepted the fact and stated (September 2008) that considering the obsolescence of machineries of the OHP, the targets of production were kept on the lower side. It was added that a new OHP would be installed after getting clearance of the State Government. The fact remains that due to non-replacement of the OHP, the Company continuously incurred loss on account of low production and higher production cost.

Loss due to sale of lump ore

2.1.12 The Company engaged (June 2003) Ares and Sons for raising and processing of iron ore at Sekradihi iron ore mines, Barbil for a period of three

[Ω] Since the Company considered efficiencies of OHP as 70 *per cent* of the rated capacity.

years from 1 July 2003 by fixing yearly targets. The contractor was to install a crusher within three months (30 September 2003) and was to raise and process four lakh MT of iron ore in the first year. The contractor could install the crusher only in November 2004 due to failure of the Company in providing suitable land since the mine is located in a reserve forest. The Company, thus, had to sell 2.24 lakh MT of lump ore instead of CLO resulting in loss of Rs. 3.72 crore towards additional net revenue (i.e. after deduction of cost of crushing).

Sale of lump ore instead of calibrated lump ore deprived the Company of earning additional revenue of Rs. 3.72 crore.

Government while accepting the delay in installation of the crusher stated (September 2008) that for liquidating the huge stockpile and in view of cash requirement of the contractor, lump ore was sold till installation of the crusher. However, Audit observed that due to deficient planning the Company failed to ensure availability of land for installation of the crusher for maximising its revenue.

Shortfall in crushing in Khandabandha Iron Ore Mine

2.1.13 The Company issued (6 July 2005) a work order to Orissa Engineers Private Limited for transportation and crushing of one lakh MT of lump ore into CLO through 40 tonnes per hour crusher of the Company at Khandabandha Iron Ore Mine with a norm of recovery of 65 *per cent* of CLO and 33 *per cent* of fines. The work order also includes repairs and maintenance of the crusher. Though the contract period was valid upto 5 July 2006, the contract was foreclosed in April 2006 for want of forest clearance.

Audit scrutiny revealed that the contractor commenced the work only in November 2005 i.e. after a delay of four months due to delay in repair of crusher by the Company. As against the revised target of crushing into 23,832 MT of CLO during November 2005 to April 2006, the actual crushing was 9,450 MT resulting in shortfall of 14,382 MT. Further, the Company sold the uncrushed lump ore from its crusher head of Khandabandha Iron Ore Mine which resulted in loss of contribution of Rs. 64.24 lakh.

Government stated (September 2008) that due to frequent breakdown of the crusher and non-availability of spare parts, the targeted production could not be achieved. The reply is not tenable since the Company issued (February 2006) purchase order for the spare parts after a delay of eight months of purchase requisition (June 2005) for which there was delay of 14 months in procurement of spare parts resulting in non-achievement of target.

Besides the above, deficiencies in management of contract in the production related areas like utilisation of equipment, loading and transportation of ores were also noticed as discussed in the succeeding paragraphs.

Infructuous expenditure in maintenance of dumpers

2.1.14 The annual repair and maintenance of 10 working dumpers at Daitari was entrusted (April 2002) to New India Supply Agencies at Rs. 48.06 lakh per annum. The rate was revised (December 2005) to Rs. 100 per available hour (Rs. 43.26 lakh[@] per annum) and extra premium at the rate of 1.5 *per cent* was payable for each one *per cent* rise above 80 *per cent* availability (assured level) of dumper hour. During 2003-08, as against the availability of 1,68,882[&] hours, the Company utilised only 37,999 hours (23 *per cent*).

Award of dumper maintenance contract disregarding the available dumper hours required resulted in avoidable expenditure of Rs. 1.53 crore.

Audit observed that while awarding the contract, the Company disregarded the available dumper hours required in view of its low level of production at OHP which rendered 77 *per cent* of dumper hours idle. Thus, the Company paid for the unutilised hours amounting to Rs. 1.29 crore towards maintenance. In addition to this, there was excess payment of Rs. 23.79 lakh towards premium.

Despite observation of audit in paragraph 2.1.20 of the Report of the Comptroller and Auditor General of India for the year ended 31 March 2004 (Commercial), Government of Orissa, Management did not revise the rate downward during renewal of the contract in December 2005.

Government stated (September 2008) that for outsourcing the work, a minimum contract value was considered to cover the establishment expenses of the contractor. It was added that when the production would go up from OHP, use of dumper would be more by which the situation reported by audit would change. The reply does not explain as to why despite the earlier audit observation, the Company did not improve the utilisation of dumpers and continuously paid higher maintenance charges.

Avoidable engagement of loading contractors

2.1.15 The Company engaged (October 2004) G.C. Mohanta for loading of ore into trucks and tippers at South Kaliapani and Sukrangi chromite mines. During 2004-08, the contractor loaded 12.02[*] lakh MT and was paid Rs. 2.80 crore.

Engagement of a loading contractor despite availability of departmental pay loaders resulted in avoidable expenditure of Rs. 2.53 crore.

Audit scrutiny revealed that the Company had a fleet of three to five pay loaders at the above mines having loading capacity of 237.87 MT per hour. During 2004-05 to 2007-08, the idle hours of those pay loaders were 1,853, 2,494, 4,205 and 4,109 hours respectively. Considering the idle hours and loading capacity of those pay loaders, the volume of ore loaded by the contractor would have required 1,274, 1,461, 1,527 and 794 hours respectively which could have been done by the Company with its available pay loaders. Thus, engagement of a loading contractor despite availability of departmental pay loaders resulted in avoidable expenditure of Rs. 2.53[#] crore.

[@] At hourly rate of Rs.100 for 14 working hours per dumper per day for 309 days in a year for 10 dumpers.

[&] Actual total shift hours available (2,28,856 hours) less total break down hours (59,974 hours).

[*] 2004-05: 3.03 lakh MT, 2005-06: 3.47 lakh MT, 2006-07: 3.63 lakh MT and 2007-08: 1.89 lakh MT.

[#] Rs.2.80 crore paid to contractor *less* average cost of POL and spares (Rs.26.54 lakh) to be spent by the Company.

Government stated (September 2008) that due to breakdown, availability hours of loaders were extremely poor and loading of saleable ore was being done manually to avoid dilution by spurious materials and labour problems. The reply is not acceptable since idle hours were calculated after considering the breakdown hours and other uses. Further, in the mechanised mines loading is done mechanically through loaders, hence, there is no risk of admixture of spurious materials. The Company should handle the labour problems amicably for optimum utilisation of the available resources.

Extra expenditure due to manual loading

2.1.16 The Company engaged (April 2005) Jai Jawan Coal Carriers Private Limited (JJCC) for manual loading of iron ore into rail wagons at Daitari Railway Siding (DRS), who continued the work up to 31 March 2008. The terms of the contract, *inter alia*, envisaged payment of loading charges at half of the agreed rate in case of mechanised loading. During 2005-08, JJCC manually loaded 22.07 lakh MT of iron ore and was paid Rs. 6.42 crore.

Non-insistence for mechanical loading by the loading contractor instead of manual loading resulted in extra expenditure of Rs. 3.21 crore.

Audit observed that despite the fact that mechanical loading was cost effective, the Company did not insist for mechanical loading by the contractor. As a result, the Company had to incur extra expenditure of Rs. 3.21 crore during 2005-08.

Government stated (September 2008) that mechanical loading could not be materialised due to labour problems. The reply is not acceptable as the Company did not force the agency to load mechanically in a phased manner by proper negotiation with labour unions.

Extra expenditure on transportation of fines

2.1.17 During October 2003 to 31 March 2008, the Company engaged four[@] contractors for raising, crushing and transportation of iron ore at Daitari Iron Ore Mines which envisaged transportation of iron ore fines both to the stockyard at Baliparbat as well as to DRS. The fines unloaded at Baliparbat were again transported to DRS for eventual sale through transportation by rail.

Multiple transportation of iron ore instead of direct transportation resulted in extra expenditure of Rs. 1.09 crore.

Audit scrutiny revealed that during October 2003 to March 2008, the Company transported 6.46 lakh MT of iron ore fines from mines to Baliparbat and from there to DRS which resulted in avoidable extra expenditure of Rs. 1.09 crore as the same could have been directly transported to the DRS.

Government stated (September 2008) that due to limited area at DRS all the stocks could not be transported directly. The reply is not tenable as the Company utilised only the platform area of 7,182 square metre out of the total area of 18,000 square metre at DRS.

[@] B.D Mohata (2004-05), Arun Udyog (2004-05 and 2005-06), Faridabad Gurgaon Minerals (P) Limited (2004-05 to 2006-07) and Kalinga Commercial Corporation (2007-08).

Lifting of ore from mine head

2.1.18 As per the terms of the agreement with three[Ψ] raising contractors entered between July 2004 and August 2005, they were required to transport the entire ore raised by them to the stockyard. Audit scrutiny revealed that during 2003-08, in Barbil and Gandhamardan regions, there was sale of 4.77 lakh MT of ore from the mines head managed by three contractors. Since transportation of 4.77 lakh MT of ore from the mines head to the stockyard was not done by the contractors, proportionate deduction should have been made from their bills. The Company, however, released full payment to the contractors which resulted in undue favour to them amounting to Rs. 39.22[β] lakh.

Government stated (September 2008) that owing to sales commitment, buyers were occasionally allowed to lift from the mines head and in absence of separate transportation rate in the agreement, the contractors were paid at the agreed rate.

Inventory management

2.1.19 The inventory of the Company mainly comprises of stock of ores, explosives, stores and spares required for repair and maintenance of mining equipment, etc. The ore stocks are kept at the stockyards of the respective mines, different railheads and portside stockyard maintained by the Company. The inventory of stores and spares are kept in different stores maintained at the mines.

Inventory of ores

2.1.20 The production, sale, shortages and closing balance of different ores during 2003-08 was as follows:

(Quantity in lakh MT)

Particulars	2003-04	2004-05	2005-06	2006-07	2007-08
Opening Stock:					
Iron Ore	8.25	6.84	3.03	3.12	14.14
Manganese Ore	1.20	1.29	1.40	1.67	1.06
Chrome Ore	4.13	3.20	2.07	2.03	3.30
Production:					
Iron Ore	23.53	27.02	31.71	46.46	51.74
Manganese Ore	1.04	0.85	0.47	0.41	0.31
Chrome Ore	7.47	6.92	6.46	12.36	11.58
Sales:					
Iron Ore	25.03	30.38	31.40	35.19	45.10

[Ψ] Pradeep Mining, B.D. Mohata and S.K. Samal.

[β] Pradeep Mining (Rs. 15.53 lakh), B.D. Mohata (Rs. 1.95 lakh) and S.K. Samal (Rs. 21.74 lakh).

Particulars	2003-04	2004-05	2005-06	2006-07	2007-08
Manganese Ore	0.93	0.74	0.21	1.03	1.34
Chrome Ore	7.41	7.21	5.53	9.89	10.92
Consumption:					
Iron Ore	0.02	0.01	0	0.01	0
Manganese Ore	0	0	0	0	0
Chrome Ore	1.01	0.77	0.88	1.16	0.73
Shortage/ excess:					
Iron Ore	0.11	-0.44	-0.22	-0.24	0.02
Manganese Ore	-0.02	-0.01	0.01	0.01	0.04
Chrome Ore	0.02	-0.07	-0.09	-0.04	-0.03
Closing Balance:					
Iron Ore	6.84	3.03	3.12	14.14	20.80[θ]
Manganese Ore	1.29	1.39	1.67	1.06	0.07
Chrome Ore	3.20	2.07	2.03	3.30	3.20

Increase in production target without evolving corresponding marketing strategies led to accumulation of stock.

It would be seen from the table that during 2006-08 as against production of iron ore of 46.46 lakh MT and 51.74 lakh MT, the actual sales were 35.19 lakh MT and 45.10 lakh MT resulting in increase in closing stock by 11.02 lakh MT and 6.66 lakh MT valued at Rs. 39.26 crore and Rs. 61.11 crore respectively. Excessive accumulation of iron ore stock indicates that the Company had not evolved marketing strategies consistent with its production targets. This has cascading effect of increased inventory carrying cost.

Blockage of fund due to accumulation of ores

2.1.21 Out of total closing stock of iron ore of 14.14 lakh MT and 20.80 lakh MT at the end of 2006-07 and 2007-08 respectively, 9.25 lakh MT (65.42 *per cent*) and 11.78 lakh MT (56.63 *per cent*) of iron were at Kurmitar mine. Similarly, the closing stock of iron ore for 2007-08 comprised 5.20 lakh MT (25 *per cent*) lying at Gandhamardan mine.

The Company awarded (June 2005) a raising contract to Kalinga Commercial Corporation (KCC) for raising iron ore at Kurmitar Iron ore mine for a quantity of 4.20 lakh MT per year. The BoD enhanced (July 2006) the quantity of production to 10.14 lakh MT based on good performance and steady sale of KCC. Similarly, the annual target of production of KCC at Gandhamardan (Hill Top) iron ore mine was increased (April 2007) to 21 lakh MT from 10 lakh MT on the similar ground.

Audit scrutiny revealed that KCC raised 40.06 lakh MT during July 2005 to March 2008 from Kurmitar mine out of which 27.47 lakh MT could be sold.

[θ] Excluding 5.18 lakh MT lying at Gandhamardan mines in contractor's account which had not been booked in the Company's account.

Increase in production led to accumulation of stocks by 22.54 lakh MT of ore resulting in blockage of fund of Rs. 71.53 crore.

Similarly in Gandhamardan (Hill Top) mine, KCC produced 19.30 lakh MT of iron ore during July 2007 to March 2008 out of which 9.35 lakh MT could be sold. Thus, increase in production target without evolving corresponding marketing strategies resulted in accumulation of stock by 22.54 lakh MT valued at Rs. 71.53 crore, which led to blockage of funds towards raising cost paid to the contractor for Rs. 41.59 crore leading to loss of interest of Rs. 17.33 lakh per month.

Government stated (September 2008) that due to booming market, the production was increased in 2006-07, but due to infrastructural constraints adequate quantity of sales could not be effected. The reply confirms the fact that increase in production in absence of required infrastructure was an injudicious decision.

Non-disposal of old stock of iron ore

Failure of the Management in disposing ores resulted in accumulation of iron ore of 1.59 lakh MT valued at Rs. 19.44 crore for more than one to four years.

2.1.22 Scrutiny of records in Barbil and Gandhamardan region revealed that 1.59 lakh MT of iron ore valued at Rs. 19.44 crore was lying undisposed (March 2008) for more than one to four years in the crusher sites and stockyards of the Company.

Though prolonged storage of ore stock is susceptible to theft/shortage/ deterioration in quality, etc., the Management did not initiate action for disposing the same.

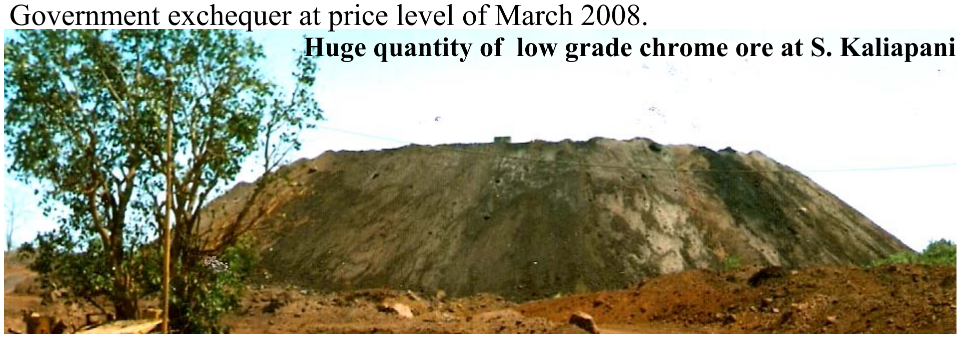
Government stated (September 2008) that ores were lying in small quantities in scattered places and steps were being taken to bring the stock to one place for sale. The fact, however, remains that lack of timely steps resulted in non-disposal of ores leading to blockage of funds.

Non-processing of old stock low grade chrome ore

Delay in installation of chrome ore beneficiation plant deprived the Company of earning net revenue of Rs. 555.81 crore and Export Duty of Rs. 90.55 crore to the Government exchequer.

2.1.23 The Company had 9.86 lakh MT of low grade chrome ore (with chrome content ranging from 32 to 40 *per cent*) since 1980. It is beneficial to process low grade chrome ore into high grade chrome concentrate in Chrome Ore Beneficiation Plant (COBP) for export. The BoD approved (March 2004) for installation of a new stand-alone COBP at an estimated cost of Rs. 22 crore with production capacity of 1.50 lakh MT of chrome concentrate per year at Kaliapani. The proposal was sent to the State Government for approval in January 2007 after a delay of about three years. Due to this delay, 9.86 lakh MT of low grade chrome ore could not be beneficiated, which could have been converted into 4.44 lakh MT of chrome concentrate generating net revenue of Rs. 555.81 crore apart from earning export duty of Rs. 90.55 crore to the Government exchequer at price level of March 2008.

Huge quantity of low grade chrome ore at S. Kaliapani



Government while accepting the delay stated (September 2008) that the tendering process had already been initiated for installation of COBP.

Non-disposal of chrome ore of closed mines

2.1.24 In Kathpal, Birasal and Kalarangi though the mines were closed during 2002, 1993 and 1998 respectively, 6,660 MT of high grade chrome ore (valued at Rs. 7.16 crore) and 25,432 MT of low grade chrome ore, respectively was lying undisposed (March 2008) for the last 5 to 14 years. Had the low grade chrome ore been beneficiated, it would have fetched 11,444 MT of chrome concentrate valued at Rs. 14.33 crore. Further, in Boula, Bangur and Sukrangi chromite mines, 20,161 MT of chrome ore valued at Rs. 12 crore was lying undisposed since 1998.

Inaction of the Company to process/sell 52,253 MT of chrome ore may result in pilferage and theft.

Government stated (September 2008) that action had been initiated for disposal of ores.

Non-disposal of manganese ore

2.1.25 In Serenda-Bhadrasahi, SGBK and Dubuna Manganese Mines 8,485 MT of different grades of manganese ore valued at Rs. 12.59 crore was lying undisposed (March 2008) for more than five years.

The mines are closed due to restrictions imposed by the forest and mining officials of the State Government. The temporary work permission also expired in case of SGBK mines. Since the demand for manganese ore had increased remarkably, the Company should have taken steps to dispose of the stock for earning revenue of Rs. 12.59 crore.

Government stated (September 2008) that action was being taken for obtaining statutory clearance for disposal of ore.

Shortages of minerals at mines and railway siding

2.1.26 The stock of iron and manganese ore in different mines and railway sidings were physically verified by the Company as on 31 March of every year. The shortages noticed in physical verification of ore as on 31 March 2007 are indicated in **Annexure 12**.

The Management did not analyse the reasons for shortage of iron and manganese ore valued at Rs. 9.39 crore.

No investigation was made by the Company to ascertain the circumstances leading to shortage of iron and manganese ore of 80,039 MT valued at Rs. 9.39 crore. Although the Company as well as the State Government lost revenue on the shortage quantity, efforts were not made to analyse/investigate reasons for the losses and fix responsibility on the erring officials.

Government stated (September 2008) that due to volumetric measurement of ores in physical verification there may be some differences. The actual figure would be known after sale only and in case of abnormal shortage reasons would be investigated. The fact, however, remains that there was shortage as per physical verification report and book balance which needs investigation.

Excess consumption of explosives

2.1.27 As per Clause 5.01 of the Efficiency Manual of OMC, each mine was required to maintain data for the number of holes made and consumption of drill rods, drilling material and explosives as well as production achieved during the month. For all these inputs, yardstick was to be fixed by a committee formed by the Company in the region for each mine separately. A monthly statement on all the items used vis-à-vis the yardstick was to be submitted by the Mine Manager and Senior Manager (Geology) to the General Manager (Production).

Audit scrutiny of records of Daitari and J.K. Road region revealed the following:

- No committee was formed to fix yardsticks for consumption of explosives in those regions.
- The production of iron ore in Daitari ranged from 3.35 to 5.57 MT per Kg consumption of explosives in departmental mines whereas in case of the mines managed by the contractors, the production ranged from 6.72 to 28.45 MT per Kg consumption of explosives during 2004-07.
- The production of chrome ore departmentally in J.K. Road region ranged from 0.93 to 5.19 MT per Kg consumption of explosives whereas in case of production by the contractor it ranged from 5.39 to 9.71 MT per Kg consumption of explosives during 2003-08 (upto February 2008). The Management, however, did not analyse the reasons for such wide variance in use of explosives.

Government stated (September 2008) that since the consumption of explosives vary depending on the ore strata in the same mine also, a uniform yardstick could not be fixed for the entire area. The fact remains that the Company did not form the Committee to fix the mine-wise yardstick for consumption of explosives as per its manual.

Inventory of stores and spares

2.1.28 The Company procures stores and spares for operation, upkeep and maintenance of OHP and mining equipment.

Audit scrutiny revealed that inventories of stores and spare parts increased from Rs. 7.97 crore in 2003-04 to Rs. 12.39 crore in 2006-07 which was 51 and 105 months' consumption respectively. The purchases of stores and spares were much in excess of the actual consumption leading to heavy accumulation of inventory. As per the Purchase Manual, purchase requisition (PR) was to be created after getting it confirmed that there was no stock of the item or the quantity in stock was less than the required quantity. Scrutiny of store ledgers pertaining to Heavy Earth Moving Machinery (HEMM), Electrical Stores of Daitari Region and COBP of J.K. Road Region revealed that the Regional Offices procured 159 items of stores valued at Rs. 37.56 lakh during October 1997 to December 2007 though there was enough stock to meet the requirement.

The Company had not evolved a system of identification of damaged/surplus/ obsolete items of stores/spares for their disposal so as to reduce carrying of unnecessary stores/spares and blockage of fund. In none of the stores "ABC" analysis of inventories, entries in bin card and age-wise analysis and identification of non-moving, slow moving and obsolete items of stores had been done.

Government stated (September 2008) that accumulation of inventory was due to obsolescence, non-functioning, etc. of some machineries. It was also added that considering the long lead time for procurement, the level of stock holding was more. The reply does not explain why the Company did not take action to identify and dispose of the obsolete and unnecessary inventories for avoiding blockage of funds. Further, the level of stock holding had not been fixed to minimise the stock holding and procedure for purchase was not followed as per the Purchase Manual.

Non-moving stores and spares

2.1.29 Audit scrutiny revealed that in eight[µ] stores 7,400 items of stores and spares valued at Rs. 1.31 crore, procured from 1983 to 2004, were not used at all so far (March 2008). Further, 702 items valued at Rs. 1.59 crore procured between April 2004 and June 2007 were not used at all. The Company neither identified the above mentioned items nor was any action taken for transfer of such items for use in other regions/disposal to avoid the obsolescence of the stores.

Government stated (September 2008) that action had been initiated for identification and disposal of non-moving stores and spares.

Slow moving items of stores

2.1.30 Scrutiny of store records of four[Ψ] stores revealed that 3,126 items valued at Rs. 87.68 lakh and 10,735 litre of lubricant valued at Rs. 7.19 lakh were not issued since September 2004 to February 2008. The purchase of such items during November 2003 to March 2008 without ascertaining the actual requirement led to blockage of funds of Rs. 94.87 lakh.

Government stated (September 2008) that some equipments had already been disposed of and the related lubricants not used for the other equipments would be disposed of through e-auction, which was under process.

[µ] Central store, Barbil, Prospecting camp store, Bangur, Central store, Daitari, Regional office store, J.K. Road, COBP store, Kaliapani, Stores located at Kaliapani, South Kaliapani and Sukrangi.

[Ψ] Central Store (HEMM), Daitari, Central Store (POL), Daitari, Central (OHP), Daitari and Gandhamardan Store.

Non-disposal of scrap material

2.1.31 As per the Purchase Manual, it was the responsibility of the user department to return the scrap of replaced spares to stores. These items were to be kept in the scrap yard earmarked in the store. The store was to maintain a register indicating the quantity/number and category of scrap material to be properly monitored through System Application and Products in data processing (SAP) system.

Test check of records in Audit revealed that in OHP stores at Daitari Mines, no scrap register was maintained as required under the Purchase Manual. Further, 2,520 items of scrap material, 1,694 meters of old and damaged conveyor belt and 56 MT of Mild Steel angle and channels were shown as returned by OHP department to stores between January 2007 and February 2008. These items were, however, not taken into account and hence could not be identified and listed for disposal.

In Gandhamardan store 2,012 different kinds of scrap material were lying in the store for more than two years without any disposal. Similarly, in COBP, Kaliapani though 17 items of new spares valued at Rs. 61.12 lakh were issued between April 2007 and February 2008, the corresponding scrap material was not returned to the stores for their disposal in violation of the extant rules of the Company.

Government stated (September 2008) that some items had already been returned to store and disposed of. The remaining items would be disposed of through e-auction for which action had been initiated except those items which would be reused after repair. The reply is, however, silent about non-maintenance of scrap registers.

Cash Management

2.1.32 Cash Management involves projection and arrangement of cash inflow/outflow as per the financial needs of an organisation. Efficient cash management provides for establishing a sound system of cash and credit control, tool of decision making for investment of surplus cash and optimum utilisation of available resources at the most favourable terms besides avoiding liquidity crunch. The cash inflow of the Company comprises mainly sale of minerals and interest on investments while the cash outflow comprises mainly administrative expenses, capital/operational and maintenance works. The details of sources and utilisation of funds of the Company during 2003-08 is shown in **Annexure 13**.

The deficiencies in cash management as analysed in audit are discussed in the succeeding paragraphs.

Delay in repayment of loan

2.1.33 The Charge Chrome Division of the Company was having liabilities in excess of its assets by an amount of Rs. 41.89 crore. The division was transferred (24 September 1991) to the Government of Orissa (GoO). As per orders of GoO, Rs. 24.18 crore was converted into interest bearing unsecured loan for a period of 12 years and the balance Rs. 17.71 crore was shown as current liabilities. The loan was to be repaid in 20 equal half yearly instalments commencing from March 1994 with interest of 15 *per cent* per annum and penal interest of 1.5 *per cent* extra in case of default in repayment.

Failure to repay the loan in time resulted in avoidable expenditure of Rs. 22.44 crore towards interest.

The Company was irregular in repayment of loan though it had surplus fund every year. It paid interest of Rs. 27.28 crore during March 1992 to October 1999 whereas it did not pay the principal amount. There was no payment thereafter upto January 2004. The Company requested (during September 2000 to August 2002) the GoO for conversion of loan into interest-free loan or equity capital stating that the State Government had neither incurred any expenditure nor sustained any liability in acquisition of the charge chrome plant and had rather made a profit. The requests of the Company were not acceded to (April 2001) by the Government on the ground that this was in violation of the transfer agreement. The Company during February-July 2004 repaid the balance outstanding dues of Rs. 45.71 crore (principal: Rs. 24.18 crore, interest: Rs. 18.13 crore and penal interest: Rs. 3.40 crore). Audit observed that had the loan and interest been paid in time as per terms and conditions of sanction of loan out of cash surplus, the Company would have paid interest of Rs. 26.37 crore and interest of Rs. 22.44 crore could have been avoided.

Government accepted the audit observation and stated (September 2008) that Government of Orissa is the 100 *per cent* shareholder of the Company and thus the ultimate interest of the owner was not affected. However, since the Company is a separate entity and therefore should have been managed professionally and the burden of extra interest should have been avoided.

Loss of interest due to delay in billing and realisation

2.1.34 As per the sales policy of the Company, the buyer after receipt of the allotment order and delivery order indicating grade, quantity and period of lifting is required to deposit the full value of the ore in advance in shape of bank drafts or valid Letter of Credit (LC) at sight duly approved by the Regional Office. Before lifting of ore, the approved common analyst has to draw the sample and submit the analysis report within five days of despatch. The analysis report is required to be submitted along with the bills to the negotiating bank at the end of the week for negotiation of LC.

Scrutiny of records for 2003-08 revealed that there was delay beyond seven days in raising bills in 1,494 cases ranging from 1 to 111 days due to late submission of analysis reports. The Company did not levy any penalty on the approved common analyst during 2003-08 as per the agreements. The delay in billing and consequent delay in realisation of sale proceeds resulted in loss of interest of Rs. 29.63 lakh at the rate of five *per cent* per annum in five regions.

It was further noticed in audit that in 1,494 cases, the bills were presented to the banks for encashment with delays ranging from 3 to 96 days resulting in

Delay in raising bills towards sale proceeds and realisation thereof resulted in loss of interest of Rs. 0.63 crore.

loss of interest of Rs. 33.31 lakh calculated at the rate of five *per cent* per annum. Further, even after commencement of billing through SAP system, the billing system was not streamlined. Thus, delay in raising bills and delay in realisation of sale proceeds resulted in interest loss of Rs. 62.94 lakh.

Government while accepting (September 2008) the fact stated that most of the delays related to the pre-SAP period. In post-SAP period, the delays were mainly due to delay in submission of analysis reports by the analysts. Though the agreements with the analysts had penal clauses, due to fewer number of analysts, it was not possible to blacklist them. The reply is contrary to the fact that out of 1,494 cases of delay in raising bills, 1,064 cases related to post-SAP period. Further, non-invocation of penal provisions of the agreements amounted to extension of undue favour.

Loss of interest due to heavy retention of balance in current account

2.1.35 The Regional Offices of the Company used to deposit the sale proceeds of ore in current account in designated banks and the surplus balance after meeting all expenses were remitted to the Head office for keeping in short term deposits. As per the direction of the Management (March 2006) the maximum ceiling to be kept in the current accounts of the regions ranged from Rupees one crore to Rupees four crore. It was noticed that all the regional offices were keeping balance in excess of the ceiling in current accounts even after meeting all expenses. Had the surplus funds been remitted to Head office for investment in short term deposits, the Company could have earned interest of Rs. 1.21 crore during 2003-08 (upto February 2008).

Government stated (September 2008) that fund was retained for settlement of raising bills in the first week of the month and the delay in remittance was due to waiting for the finalisation of sales transaction and non-availability of banking facilities in some of the remote areas. The fact remains that the Company was not adhering to its own norms for cash remittance.

Loss of interest due to keeping of surplus amount in flexi account

2.1.36 The Company opted (November 2004) for automatic conversion of current account balance to flexi deposit account and reversal for 90 days investment plan. During November 2004 to March 2008, the rate of interest of flexi account ranged from 4.25 to 5.25 *per cent* per annum. For the day to day transaction, the Company required around Rs. 15 crore per day. Accordingly the Company should have chalked out an investment plan and the amount in excess of Rs. 15 crore per day should have been invested in short term deposits where the rate of interest ranged from 6 to 11.75 *per cent* per annum during April 2005 to March 2008.

Belated decision for investing the surplus fund in flexi account led to loss of interest of Rs. 2.18 crore.

Audit observed that though there was monthly surplus funds available in flexi accounts ranging from Rs. 86 lakh to Rs. 26.37 crore, the belated decision in June 2005 and September 2006 to invest the same in term deposits resulted in loss of interest of Rs. 2.18 crore. Further, the Company did not prepare the monthly cash flow statements for proper monitoring of the investment decision.

Government stated (September 2008) that higher amounts were retained in flexi account to meet minimum need towards payment of advance tax, sales tax, income tax, etc. and also in some cases cheques were issued but not presented to bank for encashment. The reply is not relevant as audit has computed the loss of interest on the basis of minimum balance left over after meeting all such expenses during these years.

Internal control and Internal audit

2.1.37 Internal control is a management tool which helps the Management to draw reasonable assurance that its objectives are being achieved in an efficient and effective manner. The internal audit of the Company is done by firms of Chartered Accountants as per the decision of the BoD (August 2003). There was no internal audit during the period January 2003 to September 2004.

Audit scrutiny revealed that the activities were carried out on the basis of annual policies, executive instructions and circulars issued from time to time without formulating manuals even after five decades of the Company's existence. The Manual of Accounting Instructions prepared in 1975 had not been updated (August 2008). The Company had not also prepared manuals relating to its core functions viz. Contract/Production Manual, Cost and Budget Manual, Marketing and Sales Manual, Internal Audit Manual, etc.

Though there were variances in the closing balances of iron and manganese ore as on 31 March 2007 as per the Administrative Reports, report of the Indian Bureau of Mines and Physical Verification Reports of Khandabandha iron ore mine, Gandhamardan iron ore mine and Serenda Bhadrasahi manganese ore mine, the Management did not reconcile the same. Further, the quantity shown against production of iron ore relating to departmental production at OHP, Daitari during the years 2005-06 to 2007-08 was different from the quantity shown by the Mining section of Daitari which was not reconciled. It was further observed that as against the permissible limit for handling loss in HSD oil at 0.25 *per cent,* the total shortage of diesel oil due to handling loss was 1.20 *per cent* during 2003-07 in Central Store, Serenda (Barbil) and Kaliapani, which was not investigated so far (March 2008).

Government stated (September 2008) that the provisions in the manuals had been incorporated into the SAP system and steps were being taken to report the production figure uniformly. The fact, however, remains that in the absence of manuals the correctness of procedures incorporated into the SAP system could not be ensured. It was also added that action had been taken for investigation into the reasons for shortages of HSD oil.

Acknowledgement

Audit acknowledges the co-operation and assistance extended by the Management and staff of the Company at various stages of conducting the Performance Audit.

Conclusion

Though the Company was in existence for more than 50 years, it could explore only 63 *per cent* of the mining area leased to it by the Government. Despite being a major stake holder in the mineral resources of the State, its raising and processing activities still remained as areas of concern not only for efficient exploitation of mineral resources yielding more revenue to the State but also for maximising its own revenue. The Company registered shortfalls in value addition activities like production of calibrated lump ore and chrome concentrate thereby depriving it the opportunity of additional revenue. The contract management system of the Company in the areas of raising, crushing and allied activities was inadequate. The inventory management system of the Company suffered from drawbacks like non-disposal and shortages of ore besides increase in slow moving and non-moving store items. The cash management of the Company was ineffective to the extent that there was delay in repayment of loan despite surplus fund resulting in extra expenditure and retention of excess amount in the current accounts. The internal control system of the Company suffered from a number of weaknesses.

Recommendations

The Company may consider:

- **guarding against persistent shortfall in achievement of targets for production and processing;**
- **stopping sale of lump ores and sell only after crushing;**
- **taking expeditious steps for replacement of Ore Handling Plant and installation of new Chrome Ore Beneficiation Plant;**
- **strengthening the contract management system by strict adherence to the terms and conditions of the contracts;**
- **adopting a scientific basis for inventory management;**
- **strengthening the cash management system and being judicious in investment of surplus cash; and**
- **strengthening the internal control system.**

IDCOL Kalinga Iron Works Limited

2.2 Production and Sale of Pig Iron

Highlights

IDCOL Kalinga Iron Works Limited was incorporated in March 1999 and started commercial operation from March 2002 with the main aim of manufacturing and selling pig iron and spun pipes. The production performance during 2003-08 ranged between 45 and 67 *per cent* of the installed capacity.

(Paragraphs 2.2.1 and 2.2.9)

The Company sustained loss of Rs. 50.62 crore due to consumption of coke in excess of the norm.

(Paragraph 2.2.25)

Despite investment of Rs. 22.56 crore on capacity enhancement in modernisation scheme, the production remained far below the augmented capacity. Due to shortfall in production, the Company sustained loss of contribution of Rs. 45.75 crore during 2003-08 and also could not avail sales tax benefit of Rs. 6.51 crore.

(Paragraphs 2.2.8, 2.2.10 and 2.2.14)

The Company sustained loss of Rs. 21.68 crore during 2003-08 on account of processing loss, higher generation of scrap and lower grade output.

(Paragraphs 2.2.18 and 2.2.19)

Due to unplanned procurement of coke and uneconomical conversion of coal, the Company sustained loss of Rs. 19.55 crore.

(Paragraphs 2.2.30 to 2.2.35)

Due to excess consumption of iron ore over the norm, the Company sustained loss of Rs. 14.19 crore.

(Paragraph 2.2.21)

The Company sustained loss of Rs. 11.90 crore due to low plant load factor of the captive power plant and excess consumption of electricity over the norms.

(Paragraphs 2.2.22 and 2.2.24)

Introduction

2.2.1 Kalinga Iron Works (KIW), a former unit of Industrial Development Corporation of Orissa Limited (IDCOL), was incorporated (March 1999) as IDCOL Kalinga Iron Works Limited (Company) and was converted (March 2002) as IDCOL's wholly owned subsidiary Company. The main objectives of the Company were to produce, buy, sell, export and import iron, steel and raw materials used in iron and steel production and to carry on the business of iron and steel products and consultancy in and outside India.

At present, the Company's activities are limited to production of pig iron and spun pipe. It also carries out mining of high grade iron and manganese ores from the captive mines of its holding company mainly for sale outside the State. IDCOL/the Company undertook a capacity expansion programme between 1997 and 2003. The management of the Company is vested in a Board of Directors (BoD) comprising of 13 directors, including the Managing Director (MD) and the Chairman. As on 31 March 2008, all the Directors, except the Managing Director and Director (Works), were non-functional Directors. The day-to-day affairs of the Company are managed by the MD, assisted by Director (Works) and five Deputy General Managers. The Company also has one Zonal office at Kolkata to look after its selling activities. A review of Kalinga Iron Works was included in the Report of the Comptroller and Auditor General of India (Commercial) for the year ending 31 March 1994, Government of Orissa. The Report was discussed in September 2001 by the Committee on Public Undertakings (COPU).

Scope of audit

2.2.2 The present performance review conducted during November 2007 to March 2008 covers the modernisation programme, production and sale of pig iron during 2003-08. The audit findings are based on test check of records maintained at the Corporate Office of the Company, Corporate Office of the holding Company (IDCOL) and Zonal office of the Company at Kolkata.

Audit objectives

2.2.3 The Performance Audit was conducted with a view to assess whether:

- the modernisation programme was planned and carried out economically and efficiently to enhance the installed capacity with a view to achieve the desired production level;

- the Company had fixed the targets for production and sale of pig iron considering the installed capacity, availability of raw material and other resources, market demand of products and efficiently utilised the resources to achieve the same;

- regular maintenance was carried out as per planned schedule and forced outages were kept minimum;

- the sale prices were fixed protecting the financial interests of the Company;
- the top management regularly monitored the performance of the Company to ensure optimal utilisation of resources and continuous growth and improved financial results of the Company;
- a professional and adequate internal control system existed and was effectively implemented; and
- the Company complied with the norms for pollution control.

Audit criteria

2.2.4 The audit criteria adopted for assessing the achievement of the audit objectives were:

- installed capacity of the plant for production of pig iron, norms established by the Company for consumption of various raw materials and other inputs;
- procurement policy, standard principles of material management and budgeting;
- techno-economic viability (TEV) Report and perspective plan of Metallurgical & Engineering Consultants (India) Limited (MECON) and other reports related to modernisation schemes;
- target for sales of pig iron and granulated slag;
- approved policies for fixation of selling prices of various products, cash discounts, quantity discounts, rebates and credit policy for sale; and
- minutes of meetings of BoD, norms of the State Pollution Control Board and standards in respect of Internal Control System.

Audit methodology

2.2.5 The audit methodologies adopted for achieving the audit objectives with reference to audit criteria were:

- examination of records relating to budgets, targets, financial performance and maintenance programme, production, conversion of coke, consumption of raw materials, coke, power and other inputs;
- examination of records involving sales, fixation of sale price agreements relating to selling of pig iron and disposing of slag/scrap;

- examination of records relating to procurement of plant and machinery, equipment, raw materials, stores and spares and purchase of power and other inputs;

- study of detailed project reports, feasibility reports, techno-economic reports, manpower study reports for modernisation and improvement of production, cost audit reports, annual accounts, agenda notes and minutes of board meetings and audit committee meetings; and

- interaction with the Management.

Financial position

2.2.6 The table below summarises the financial position of the Company for the last four years ended 31 March 2007.

(Amount: Rupees in lakh)

Particulars	2003-04	2004-05	2005-06	2006-07
A. Liabilities				
a) Paid up capital	3010.00	4510.00	4510.00	4510.00
b) Reserves and surplus	-----	-----	-----	------
c) Borrowings	9470.64	9530.77	8950.81	7902.34
d) Trade dues and other liabilities	3026.74	7071.21	5605.14	5209.45
Total	**15507.38**	**21111.98**	**19065.95**	**17621.79**
B. Assets				
a) Gross block	10456.89	10479.89	10525.96	10630.38
b) Less: Depreciation	929.42	1409.11	1887.23	2371.48
c) Net fixed assets	9527.47	9070.78	8638.73	8258.90
d) Capital work-in-progress	9.23	--	36.43	--
e) Investments	0.03	0.03	0.03	0.03
f) Current assets, loans and advances	4927.22	8984.51	6704.83	7325.40
g) Miscellaneous expenses including accumulated loss	1043.43	3056.66	3685.93	2037.46
Total	**15507.38**	**21111.98**	**19065.95**	**17621.79**
Capital Employed	**11437.18**	**10984.07**	**9774.85**	**10374.85**
Net worth	**1966.57**	**1453.34**	**824.07**	**2472.54**

Note: Management has not compiled the figures for 2007-08.

Audit findings

The findings of the Performance Audit of the Company were reported (June 2008) to the Government/Management and also discussed (4 August 2008) in the meeting of the Audit Review Committee for State Public Sector Enterprises (ARCPSE) which was attended by the Commissioner-cum-Secretary, Department of Industries of the State Government, the Chairman and the MD of the Company. The views of the Management/Government have been taken into consideration while finalising the review. The audit findings are discussed in the succeeding paragraphs.

Production process

2.2.7 Iron Ore lumps, after crushing and screening into size (10 mm - 30 mm), are washed with water and fed into the scale car through which the ore is transported and fed into the Blast Furnace (BF). The screened coke is then fed as fuel into the BF. Additives like limestone, dolomite, quartzite and manganese ore are also fed into the BF. Hot air (850^0 – 900^0 C) is blown through narrow combustion type stoves into the BF. In the process the ore gets reduced into molten iron, called hot metal. Hot metal is transported to the Pig Casting Machine (PCM) by loco/ladle transfer car where around 94 *per cent* of the hot metal is poured into PCM for production of pig iron and the rest is taken to the spun pipe plant, where Cast Iron (CI) Spun Pipe is manufactured.

Unfruitful implementation of modernisation scheme for capacity augmentation

2.2.8 The Company has four BFs with useful volume of 254 cum (41 cum of BF-1 and 71 cum each of BF-2, 3 and 4) for production of 1.57 lakh MT of pig iron per annum. It has two lines of pig casting machines for conversion of hot metal into pig iron. To meet the enhanced demand for pig iron, IDCOL/ the Company increased (1997 to 2003) the total capacity of all the four BFs to 2.20 lakh MT of hot metal by enhancing the useful volume to 355[#] cum at a cost of Rs. 22.56 crore up to December 2003. The Company, however, could not operate the BFs on a sustained basis. Hence, the Company appointed (December 2003) MECON as a consultant for examining the problems. MECON submitted (February 2004) a Techno-Economic Viability (TEV) report, which stated that non-achievement of the installed capacity by the Company was due to inadequate infrastructure facility, old technology and ageing of equipment.

MECON estimated an expenditure of Rs. 31 crore for balancing the infrastructure for optimum utilisation and maintaining the health of the plant. The Company, after a lapse of three years, decided (January 2007) to implement the recommendations of TEV report and formed a Directors-level Task Force Committee (TFC) to examine and suggest requirement of capital expenditure. The TFC recommended (February 2007) an estimated capital expenditure of Rs. 23.50 crore. The TEV report was approved (April 2007) by the BoD of IDCOL and by the State Government in July 2007. The project was under implementation and actual expenditure incurred was Rs. 2.34 crore upto March 2008.

Audit scrutiny revealed the following:

Mismatch in capacity augmentation with infrastructure rendered idling of one blast furnace valued at Rs. 15 crore.

- Due to delay in taking remedial action to balance the production capacity with matching infrastructure like provision of additional PCM, stoves, etc. the Company could not operate four BFs on sustained basis and thus one BF valued at Rs. 15 crore was kept idle.

[#] BF-1 to 100 cum and BF-2, 3 and 4 to 85 cum each.

The pig iron production remained at the level of 0.99 lakh MT to 1.47 lakh MT as existed prior to capacity enhancement as discussed vide Paragraph 2.2.9.

- In terms of the Industrial Policy Resolution, 1996 of Government of Orissa, the benefit of exemption of sales tax was admissible upto 100 *per cent* of additional capital investment in plant and machineries for six years in respect of incremental sales per annum over the highest sales registered in previous five years. Since the Company spent Rs. 21.13 crore upto 4 October 1999 on modernisation of BF-1 for augmentation of its capacity from 30,000 to 72,000 MT per annum, it could have availed sales tax exemption of Rs. 8.69 crore during 5 October 1999 to 4 October 2005. Due to marginal increase in sales over the highest sale of Rs. 83.97 crore (1996-97) in the last five years, during 2001-02, 2003-04 and 2004-05, the Company could avail sales tax benefit of Rs. 2.18 crore only resulting in lapse of balance amount of Rs. 6.51 crore.

Due to shortfall in production there was non-availment of sales tax benefit of Rs. 6.51 crore.

- Delayed implementation of the TEV report to install balancing equipments resulted in (i) under utilisation of installed capacity (paragraph 2.2.10), (ii) lower productivity of the plant (paragraph 2.2.14), (iii) generation of low grade pig iron and scrap in excess of the approved norms (paragraph 2.2.18) and (iv) production of pig iron at higher cost due to higher rate of coke consumption and other inputs (paragraphs 2.2.24 and 2.2.25).

Government accepted (September 2008) the fact that four BFs could not be operated due to absence of related infrastructure and after increase in the useful volume of BFs, the pouring capacity was not increased to match with increased productivity. It was added that action was being taken to procure one new PCM as per the suggestion of MECON. Further, it was stated that during the period of benefit there was low production due to various reasons for which IPR benefit could not be availed.

Production performance

2.2.9 The production of hot metal during 2003-08 compared to installed capacity after modernisation of blast furnaces vis-à-vis the budgeted targets are indicated below:

Year	Installed capacity (lakh MT)	Budgeted capacity (lakh MT)	Produ-ction (lakh MT)	Achievement (*per cent*) as to		Shortfall in production with reference to installed capacity (lakh MT)
				Installed capacity	Budgeted capacity	
2003-04	2.20	1.59	1.40	64	88	0.80
2004-05	2.20	0.59	0.99	45	168	1.21
2005-06	2.20	1.62	1.27	58	78	0.93
2006-07	2.20	1.45	1.47	67	101	0.73
2007-08	2.20	1.75	1.46	66	83	0.74
Total	**11.00**	**7.00**	**6.59**			**4.41**

It would be seen from the table that during 2003-08, the hot metal production ranged between 45 and 67 *per cent* of the installed capacity and 78 and 168 *per cent* of budgeted production.

Budgeted production was fixed on the basis of anticipated number of days of operation of BFs and was below the installed capacity as BFs were kept idle. The lower production of hot metal was attributable to poor utilisation of BFs and lower productivity of the plants as discussed in paragraphs 2.2.10 and 2.2.14.

Government stated (September 2008) that due to severe market recession during 2003-06 and due to want of matching infrastructure and required man power it was not economical to operate four furnaces. The reply is not acceptable since though the Company could sell 99 *per cent* of the produced quantities with higher contribution during 2003-06, production could not be enhanced as related infrastructure was not envisaged at the time of capacity enhancement of BFs.

Low production due to poor utilisation of BFs

2.2.10 As against availability of 1.68 lakh hours during 2003-08, four BFs were actually operated only for 1.20 lakh hours (71.55 *per cent*). As a result, the Company incurred loss of contribution of Rs. 35.84 crore as detailed below:

Year	Available Hours[β]	Working Hours	Production (MT)	Production per hour (MT)	Loss of production hours	Loss of Production (MT)	Contribution per MT (Rs.)	Amount (Rs. in crore)
2003-04	33600	24330	140130	5.76	9270	53395	2510	13.40
2004-05	33600	20134	99215	4.93	13466	66387	50	0.33
2005-06	33600	23381	126710	5.42	10219	55387	860	4.76
2006-07	33600	25646	147457	5.75	7954	45735	2448	11.20
2007-08	33600	26727	146422	5.48	6873	37664	1632	6.15
Total	**168000**	**120218**	**659934**		**47782**	**258568**		**35.84**

Failure to utilise blast furnaces in the available hours resulted in loss of contribution of Rs. 35.84 crore.

The main factors attributable to loss of production hours (47,782) of BFs resulting in loss of contribution of Rs. 35.84 crore were excess time taken in relining of furnaces (25,920 hours), shortage of raw materials (8,665 hours), and other technical problems (13,197 hours) which are discussed in the succeeding paragraphs.

Shutdown due to relining works

2.2.11 As per norms adopted by the Company, the relining of BFs was to be carried out within a period of 90 days in a span of five to six years. Actual relining time taken by the Company was 548 days, 348 days, 118 days[¥] and 370 days for BF-1, BF-2, BF-3 and BF-4 respectively during 2003-08.

[β] Available hours is based on 350 days in a year considering 15 days (16 days in leap year) for planned shutdown for four BFs running for 24 hours.
[¥] Total relining period was 916 days, but 118 days related to 2003-04 and the balance related to 2000-01 to 2002-03.

Due to lack of proper planning and proper monitoring, the relining of blast furnaces could not be done within the norm of 90 days.

The main reasons for such abnormal higher number of days taken for relining were lack of proper planning and poor monitoring system in the procurement of material and execution of works. In spite of the directive (September 2003) of the BoD that all the required material should be procured first and then shutdown of furnace was to be done, the same was not followed by the Company. Test check of relining activities of two furnaces (BF-1 and BF-2) revealed the following:

- The BoD approved (December 2005) shutdown of BF-1, but the furnace was actually shutdown on 6 March 2006 without procurement of refractories and other required material. Order for supply was placed on Simplex Engineering and Foundry Work Limited on 8 June 2006 with scheduled delivery period of six to eight months. Thus, the entire relining work was completed on 5 September 2007 i.e. after 548 days (13,152 hours) as against the scheduled period of 90 days due to improper planning, monitoring and delayed procurement of material.

- Similarly, BF-2 was shutdown on 2 November 2003 for capital repair/relining and increase of stack height without first indenting the required material. Due to delay of 50 days in procurement of refractory bricks, the furnace relining work was completed only on 20 February 2004 against the scheduled date of 1 January 2004. The operation of furnace was, however, started only on 15 October 2004. The reason for keeping the furnace idle for eight months after repair was not on record.

Government stated (September 2008) that BF-1 was chilled and there was build up inside it for which it was difficult to clean the jam. Further, modification of stoves was carried out during that period and there was delay in receipt of top equipment from the supplier. The fact remains that cleaning of jam is a part of relining work and modification work of stove was not planned before shutdown. Besides, advance planning was not made for procurement of material before carrying out the relining work.

Shutdown for shortage of raw material

Due to shortage of coke, the BFs remained idle for 8,665 hours.

2.2.12 The plant remained shutdown for shortage of raw material, for 8,665 hours during 2003-08. Against monthly consumption of 9,000 MT of coke, the monthly stock holding ranged between 983 MT and 9,860 MT during 2003-08. The Company did not fix the minimum, maximum and re-ordering level of stock holding for coke despite this being the main raw material. The Company also did not have a long term plan for procurement of coke on a sustained basis. Coke was procured on piecemeal basis from different sources leading to mismatch between requirement and consumption resulting in shutdown of the furnaces. The details of improper planning and procurement of coke are discussed in paragraphs 2.2.30 and 2.2.31.

Government stated (September 2008) that coke price was fluctuating widely and it was difficult to keep more stock. Further, when the price of pig iron was also fluctuating it was difficult to fix minimum/maximum/reorder level of coke. However, no arrangement was made to procure coke from suppliers on regular basis to run the furnaces smoothly.

Shutdown for operational and maintenance troubles

2.2.13 The Company neither fixed any norm nor any scheduled shutdown programme for regular repair and maintenance of BFs. The maintenance works were attended to only after actual operational troubles occurred. Hence, the furnaces remained shutdown for 13,197 hours during 2003-08 for operation, maintenance and other technical problems. The impact of unscheduled shutdown is discussed in paragraph 2.2.10.

Government stated (September 2008) that the miniature low shaft type furnaces being very old, required frequent maintenance. The reply is not acceptable as no planned shutdown programme was maintained in spite of Board's decision in this regard in January 2004.

Low production due to lower productivity of the plant

Failure to achieve the envisaged productivity resulted in loss of contribution margin of Rs. 9.91 crore during 2003-08.

2.2.14 On the basis of installed capacity and available hours during 2003-08, the production per hour of BF-1 worked out to 7.07[#] MT and that of BF-2, 3 and 4 worked out to 6.01[$] MT each. The actual production per hour achieved by the Company ranged from 4.18 to 6.41 MT and 4.45 to 5.85 MT respectively for BF-1 and BF-2, 3 and 4 during 2003-08. The low productivity resulted in loss of contribution margin of Rs. 9.91 crore during 2003-08 as per details in **Annexure 14**.

Government stated (September 2008) that due to mismatch between production capacity and required infrastructure, low quality of coke, etc. productivity could not be maintained. The fact remains that required infrastructure was not envisaged along with capacity enhancement of BFs.

Inadequate BF stoves with low blast temperature

2.2.15 Efficient furnace operation depends on temperature of BFs to be maintained at 850^0 to 900^0C. Blast furnaces-2, 3 and 4 were provided with three stoves each whereas BF-1 was provided with only two stoves which were also smaller in size. Though the useful volume for BF-1 was increased from 41 to 100 cum, no action was taken under the modernisation scheme to increase the number of stoves or to augment their capacity. As a result, the required hot blast temperature could not be maintained continuously thereby affecting the production. Further, the BF-3 and 4 were catered to by a battery of six stoves and one common waste gas chimney. As there was increase in the capacity of BFs there was also necessity to enhance the capacity of the chimney to exhaust the increased volume of waste gas. The Company did not take any action despite recommendation by MECON (February 2004) for modification/addition of stove of BF-1 and modification of chimney between BF-3 and BF-4. Had action been taken to maintain the required temperature

[#] {61975 MT/(365x24)}, (Installed capacity of BF is fixed for 365 days operation in a year).
[$] {52675 MT/(365x24)} (Installed capacity of BF is fixed for 365 days operation in a year).

Non-maintenance of the required temperature of BFs resulted in loss of production by 170 MT per day.

continuously, the production could have been increased by at least 170 MT per day as analysed by the Management.

Government stated (September 2008) that action was being taken to modify the brick quality of stoves gradually to get required blast temperature.

Ageing effects of blowers

2.2.16 Oxygen enrichment is required for burning of coke at high temperature and pressure for reduction of iron ore to molten hot metal. Supply of oxygen is done by blowers, which suck air from the atmosphere and deliver the same to the blast furnaces through stoves in the required quantity and pressure. The Company had commissioned five blowers, which were very old (between 36 and 47 years) and were operated below the desired level due to frequent breakdown and less co-ordination between stove and blower operation. Audit scrutiny revealed that frequent problems in the blowers resulted in stoppage of the BFs for 427 hours during 2003-08 leading to loss of production.

Government stated (September 2008) that action had been taken to procure a new blower to match with the increased capacity.

Inadequate casting capacity

2.2.17 Hot metal produced from the BFs is transferred through ladle cars to the PCM for casting into pig iron (saleable product). The plant had two strand PCMs, commissioned in 1968 and 1985 of 40 tonne per hour (tph) rated capacity. Due to ageing, the rated capacity as well as casting speed of PCMs was decreased to 50 *per cent*. Due to inadequate casting capacity production was to be restricted. MECON recommended (February 2004) for installation of one additional PCM at an estimated cost of Rs. 1.80 crore for enhancement of production and reduction of higher generation of scrap. The work had not started (August 2008). Non-modification of the PCMs resulted in the following deficiencies:

- Tapping was delayed due to busy PCM as a result of which production was reduced;
- Delayed pouring resulted in low hot metal temperature and consequential loss of graded pig iron production;
- Spillage in the system resulted in higher scrap generation; and
- There was high maintenance cost due to the old design.

Thus, the Company could have avoided shortfall in production of hot metal as discussed in paragraph 2.2.10 and excess generation of scrap as stated in paragraphs 2.2.18 and 2.2.19 had provision been made for installation of one additional PCM at the time of modernisation of BFs itself.

Government stated (September 2008) that efforts were being made as per the recommendation of MECON to enhance the PCM capacity.

Melting loss and generation of ungraded pig iron

The melting loss and scrap generation was excess over the norm resulting in loss of Rs. 16.96 crore during 2003-08.

2.2.18 In the process of production of pig iron there is process/melting loss from hot metal to cold metal and generation of scrap/ungraded pig iron from cold metal to graded pig iron. The Company's budgetary norm is 1.5 *per cent* for melting loss and 4.5 *per cent* for scrap. The actual melting loss during 2003-08 ranged from 1.95 to 3.83 *per cent* causing excess melting loss of 10,846 MT valued at Rs. 13.97 crore. The actual scrap loss during the period ranged from 5.80 to 6.35 *per cent* causing excess generation of scrap of 6,886 MT valued at Rs. 2.99 crore being difference in price of pig iron and scrap.

Though a committee was formed in February 2004 for identifying reasons for generation of excess melting loss, no analysis had been made so far and no remedial measure was taken to arrest the same. The generation of excess scrap was due to inefficiency of PCM to handle production as delayed pouring was resulting in temperature loss leading to generation of scrap.

Government while accepting the fact stated (September 2008) that due to problems in PCM, ground pouring was done for which there was conversion loss and increase in scrap for which action was being taken to increase the efficiency of PCM and quick movement of ladles.

Generation of lower grade pig iron

Production of inferior grade of pig iron resulted in loss of Rs. 4.72 crore.

2.2.19 The BFs of the Company are designed to produce foundry grade pig iron. The normal production of pig iron (LM 2 grade) by the Company is having above two *per cent* silicon. During 2003-08, instead of LM 2 grade, the Company produced 68,365 MT of LM 3 grade and 14,717 MT of LM 4 grade pig iron having low market price, which resulted in loss of Rs. 4.72 crore. The reasons for generation of grade 3 and 4 pig iron were not available from the records.

Government stated (September 2008) that due to variation in raw material and higher moisture content there was erratic behaviour of BFs and silicon percentage was reduced. The fact remains that the Company did not take remedial action to arrest the same.

Management of inputs

2.2.20 The Company's major inputs (raw material) comprise iron ore lump, metallurgical coke and power. The procurement, consumption and inventory management of major inputs are discussed below:

Iron ore

2.2.21 For production of pig iron, the primary raw material is iron ore lumps. As per the Company's norms, 1.5 MT of iron ore lump is required for

Consumption of iron ore lump in excess of the norm by 1.39 lakh MT during 2003-08 led to excess expenditure of Rs. 14.19 crore.

production of one MT of hot metal. During 2003-08 the Company consumed 11.29 lakh MT of iron ore as against the required quantity of 9.90 lakh MT. The excess consumption of iron ore was 1.39 lakh MT being 14.04 *per cent* of the required quantity. This has resulted in extra expenditure of Rs. 14.19 crore during 2003-08.

The main reasons for excess consumption of iron ore lump was higher percentage of fines (undersize lump) in the iron ore lump. As per requirement of the plant the lump ore size was 10 to 30 mm. The Company was procuring iron ore lumps from outside parties having fines of 7 *per cent*. During 2003-08, fines in iron ore were 1.40 lakh MT being 12.40 *per cent* of iron ore consumed. The reasons for such high percentage of fines in iron ore was not analysed by the Management.

Government stated (September 2008) that iron ore received from the captive mines had larger content of under size fines and more fines were generated due to multiple handling inside the plant. The fact is that the Company used only four *per cent* of captive ore in their consumption which contained seven *per cent* of fines. Further, it neither analysed the reasons nor took remedial measures to stop excess generation of fines.

Power

Consumption, generation and shortfall

2.2.22 The Company has a captive power plant (CPP) with four units of 4 MW each. The gas generated from the blast furnaces is used as fuel in the CPP for generation of electricity. The maximum requirement of power by the Company was 7.7[#] MW for operation of four furnaces.

As against a demand of 200.07 MU, the generation from CPP was only 162.36 MU leading to excess expenditure of Rs. 6.77 crore on purchase of power.

The CPP had the capacity to generate 315.36[$] MU power even at 50 *per cent* load factor (PLF) and 90 *per cent* power factor during 2003-08. The CPP, however, generated only 162.36 MU of power during 2003-08 against a demand of 200.07 MU. As a result, the Company had to purchase 37.71 MU of power from NESCO at a higher rate (Rs. 2.35 / Rs. 3.20 per unit) compared to own cost of generation at Re. 0.96 per unit resulting in avoidable loss of Rs. 6.77 crore. Audit observed that during 2003-08 there was less generation of power from the CPP as its PLF ranged from 18 to 28 *per cent*. Further, there was increased consumption of power in the pig iron division since the per metric tonne consumption of power ranged from 237 to 278 kwh against the norm of 222 kwh. These factors contributed to purchase of power from NESCO at higher rate. The causes of low PLF and increase in consumption of power in pig iron division are discussed in the following paragraphs:

[#] 4.8 MW for four BFs, 1.7 MW for SPD, 0.9 MW for colony and 0.3 MW for CPP

[$] 4 unit x 4 MW x 0.5 capacity x 0.9 power factor x 24 hours x 1,000 (conversion factor MW to KW) x 1,825 days)

Low plant load factor of CPP

2.2.23 The main reasons for low generation of power from CPP were inadequate availability of BF gas and lower steam production from old boilers.

The BF gas available from operation of two boilers is sufficient to generate 7.7 MW of power from CPP. Against rated capacity of generating steam of 40 tph by two boilers the actual generation ranged from 16 to 17 tph due to inefficiency of boilers. Consequently, the actual power generation ranged from 2.13 to 4.80 MW during 2003-08. MECON recommended (February 2004) for health study on all the three boilers at an estimated cost of Rs. 30 lakh. The Company did not take action in this regard so far (August 2008).

Government stated (September 2008) that due to reduction of CO content in gas the maximum amount of steam that could be generated was only 16 to 17 tph which could generate 3 to 3.2 MW of power. Aging factor of boilers also contributed to lower output. However, the reduction in CO percentage was only 16 *per cent* after increase of stack height of the BFs whereas generation of power was only 18 to 28 *per cent* of rated capacity of CPP. The fact remains that the boilers were not operating to the rated capacity since action was not taken for carrying out their health study as recommended by MECON.

Increase in consumption of power

2.2.24 The Company has not fixed norms for consumption of power per MT of hot metal/pig iron despite operation of plant for more than 25 years.

Excess consumption of electricity in the pig iron division beyond the norm resulted in loss of Rs. 5.13 crore.

During 2003-08, the Company consumed 157.92 MU for production of 6,39,189 MT of pig iron. Considering average consumption of 222 kwh per MT of pig iron during 2000-03 as base consumption, the required consumption of power was 141.90 MU[@]. Thus, there was excess consumption of power which worked out to 16.02 MU valued at Rs. 5.13[¥] crore. Audit scrutiny revealed that the decision of BoD in January 2004 to install meters for energy monitoring in high consuming areas like PCM, work shop and conveyors and replacement of less efficient motors was not carried out. Further, the recommendation (June 2006) of Energy Audit Team for installation of one variable speed drive equipment at a cost of Rs. 1.73 crore with pay back period of six years to save one lakh unit of energy every month was not implemented (August 2008).

Government stated (September 2008) that action was being taken for phase-wise replacement of less efficient motors and installation of variable speed drive equipment could not be finalised as it required investment of Rs. 2 crore. However, the Company would recover the investment within six years.

[@] Production 6,39,189 MT X 222 kwh per MT = 14,18,99,958 (say 141.90 MU).
[¥] 157.92 MU – 141.90 MU = 16.02 MU X Rs.3.20 per kwh =Rs.5.13 crore.

Coke

Excess consumption of coke over norm

The Company incurred loss of Rs. 50.62 crore due to consumption of coke in excess of norms by 49,371 MT during 2003-08.

2.2.25 Coke is used in the blast furnace as a raw material. It constitutes about 70 *per cent* of the cost of production of pig iron. As per technical parameter for consumption of coke by BF, 750 kg coke is required for production of one tonne of hot metal. During 2003-08, the Company consumed 5,44,321 MT of coke for production of 6,59,934 MT of hot metal resulting in excess consumption of 49,371 MT of coke valued at Rs. 50.62 crore. The excess consumption during 2003-08 was 6 to 16 *per cent* of the total consumption.

The higher rate of coke consumption was attributable to unfavourable condition of furnace, use of HAM (High Ash Metallurgical) coke in place of LAM (Low Ash Metallurgical) coke, not using sinter[#] in place of coke, as suggested by MECON in September 2004, frequent breakdown/forced shutdown of BFs, etc. as discussed in the succeeding paragraphs.

Government stated (September 2008) that higher coke consumption in 2003-05 was due to high moisture content in the coke. The reply is not acceptable as there was excess consumption of coke during 2003-08 which was calculated in audit after excluding moisture content.

Unfavourable condition of furnace

2.2.26 To ensure efficient furnace operation, the required flow rate and temperature of blast air must be maintained. MECON, in their TEV report (February 2004), suggested for a new stove to raise BF temperature by 150^0C but no action was taken (August 2008). The shortfall of required temperature of the BF is met through excess consumption of coke.

Government stated (September 2008) that order was being placed for procurement of a new stove.

Use of HAM coke in place of LAM coke

2.2.27 Use of HAM coke increases the consumption and adversely affects the health of BF. The Company used only 35.38 and 37.41 *per cent* of LAM coke in the years 2003-04 and 2004-05 respectively and coke consumption rate was higher as discussed in paragraph 2.2.25. From January 2005 procurement of LAM coke was started from Metal and Mineral Trading Corporation Limited (MMTC) and thereafter use of LAM coke in the furnace increased to 86.57 and 81.54 *per cent* in the years 2005-06 and 2006-07 respectively by which the coke consumption was reduced. No techno-economic study was, however, carried out for optimal use of HAM coke in the context of its suitability in the furnaces. Further, MECON in their perspective plan submitted in August 2004 recommended for use of sinter as a substitute for coke up to 80 *per cent* by which the norm of coke consumption would be reduced to 640 kg per tonne of hot metal. During 2003-08 the Company used only 20 to 25 MT of

[#] Sinter is made out of mixture of iron ore and coke fines.

briquette/sinter per day in the furnace which was only six *per cent*. The proposal to increase the use of sinter by upgrading the plant capacity was yet to be implemented (August 2008).

Government stated (September 2008) that more HAM coke was used in the furnace due to non availability as well as higher price of LAM coke in the market and action was being taken to have a sinter unit. The fact remains that the LAM coke was available in the market from the suppliers viz. Durgapur Project limited (DPL), Neelachal Ispat Nigam Limited (NINL) and MMTC. Though an MOU was signed with MMTC in November 2003 to procure LAM coke as well as imported coal (for conversion into coke), the Company did not procure coke/coal as per MOU.

Frequent shutdown of furnaces

2.2.28 Due to frequent breakdown, the furnaces consume more coke for generation of heat during the startup period. During 2003-08 furnaces were shutdown for a total period of 55,174 hours. The BoD recommended (January 2004) that the reasons for shutdown be identified and proper planning be made in such a way that breakdown from May 2004 except planned shutdown should be within the norms of 15 days in a year. The Company, however, did not take remedial measures so far (August 2008).

Government stated (September 2008) that BFs were shutdown for want of matching infrastructure, shortage of raw material and operation and maintenance trouble. Audit, however, observed that the Company did not envisage the installation of infrastructure at the time of capacity enhancement and did not follow definite procurement policy for availability of raw material and no remedial action was taken to arrest forced shutdown.

Procurement of coke

2.2.29 The Company's BFs require LAM coke for production of pig iron. It was meeting coke requirement mainly through imports and partly through conversion of coal into coke in the joint venture coke oven plant of Utkal Moulders Limited (UML). During the year 2003-08 the Company procured 6,75,630 MT of coke at a cost of Rs. 694.67 crore. The Company, however, has not evolved any long term planning for procurement based on realistic assessment. The Company sustained loss of Rs. 10.49 crore due to improper planning and not following commercial prudence in the procurement as discussed below.

Unplanned procurement of coke

2.2.30 The Company requested (December 2006) MMTC to import 30,000 MT of LAM coke. MMTC offered (February 2007) to supply 15,000 MT of Chinese origin coke at CIF price of US$ 219 per MT by 15 March 2007 and 30,000 MT at US$ 211 per MT in April 2007. MMTC also indicated (February 2007) that coke price and freight rate was increasing in the international market. With subsequent time extension the Company accepted (23 February 2007) the offer to procure only 15,000 MT of coke.

Unplanned procurement of coke despite aware of increase in market price resulted in additional expenditure of Rs. 7.35 crore.

The Company again requested (10 April 2007) MMTC to procure 30,000 MT of LAM coke for consumption during May 2007 onwards. In the meantime, the coke price in the international market had gone up and MMTC agreed (30 April 2007) to arrange the coke at US$ 273.25 per MT. The Company purchased (May 2007) 32,519 MT from MMTC and incurred an additional expenditure of Rs. 7.35 crore* compared to the earlier offer due to unplanned procurement.

Government stated (September 2008) that procurement of 30,000 MT was not considered as sulphur content in the offered coke was 0.65 *per cent* against the requirement of maximum 0.60 *per cent*. The contention of the Company is not acceptable as it was procuring coke from MMTC with specification of sulphur content of more than 0.65 *per cent* and from other sources without any specification. Moreover, physico-chemical characteristic of raw material envisaged for the BF does not stipulate any norm for sulphur content in coke.

Procurement of coke on piecemeal basis

Purchase of coke on piecemeal basis resulted in extra expenditure of Rs. 3.14 crore.

2.2.31 The Company proposed (24 March 2006) for procurement of 30,000 MT of imported LAM coke against offer (22 March 2006) of MMTC of 15,000 MT of LAM coke at US$ 152 (Rs. 7045) PMT and 30,000 MT of LAM coke at US$ 150 (Rs. 6950) PMT. The CMD/IDCOL approved (25 March 2006) for purchase of 15,000 MT only at US$ 152 and asked to resort to an alternative long term arrangement with NINL. MMTC supplied (June 2006) 14,524 MT of LAM coke of Rs. 10.22 crore (Rs. 7,038 per MT). The Company procured the balance requirement of 15,614 MT of LAM coke from the local market on piecemeal basis during June-September 2006 at higher price ranging from Rs. 1,563 to Rs. 2,048 per MT. Had the Company procured 30,000 MT of coke from MMTC in June 2006 it could have avoided extra expenditure of Rs. 3.14 crore.

Government stated (September 2008) that procurement of 30,000 MT of coke from MMTC was not considered with the assumption that NINL coke would be available at Rs. 8,250 PMT, selling price of pig iron was not encouraging and the Company was making loss. The reply is not acceptable since the Company was aware of higher price of NINL coke than that of MMTC. Further, in view of contribution of Rs. 860 PMT during 2005-06, the contention of the Company that selling price of pig iron was not encouraging is not correct.

Unfruitful joint venture on coke oven plant

Joint Venture with UML

2.2.32 A Memorandum of Understanding (MOU) was signed (August 1992) by the Company with UML for setting up of a captive Coke Oven Plant (COP) in a joint venture on 23.49 acres of land belonging to the Company and subleased to UML. The COP started functioning (December 1999) and the coke produced was supplied to the Company, which was stopped (August

* {(30,000 X (US$ 273.25 minus US$ 211) X Rs.39.3525 exchange value}

2002) due to a dispute over quantity and quality of coke received from UML. The matter is subjudice (August 2008); the High Court of Orissa directed (August 2003) that pending settlement of the case, the COP should be put into operation.

The Company incurred loss of Rs. 1.56 crore due to uneconomical conversion of HAM coke during April to July 2005.

The COP restored production from March 2005 and the procurement of HAM coke by the Company was resumed from April 2005. The decision to procure converted coke from COP was taken by the Company on the ground that it would be economical. The Company also procured HAM coke from other suppliers upto July 2005 and subsequently procured HAM coke from COP only. A comparison of cost of HAM coke procured from COP and other suppliers during April to July 2005 revealed that considering the cost, moisture content and fines in the converted coke of UML, the landed cost of UML coke was higher than the cost of coke purchased from the market by Rs. 1,480 to Rs. 1,776 per MT. Thus, the Company incurred loss of Rs. 1.56 crore due to uneconomical conversion of HAM coke in JV plant during April to July 2005. Despite costlier HAM coke of COP, the Company continuously procured 1,10,904 MT of HAM coke from COP during August 2005 to March 2008 at a total cost of Rs. 95.03 crore.

Government stated (September 2008) that as per the contract, moisture beyond seven *per cent* was to be computed to tonnage and was to be deducted from the receipt weight and generation of fines was due to internal handling, which may not be compared with purchased coke. It was further stated that quality of HAM coke purchased earlier contained high ash to the extent of 31 *per cent* compared to 27.49 *per cent* in the converted coke, which adversely affected furnace operation. The reply is not acceptable as no deduction was made for the moisture content in the coke supplied by UML while taking coke into stock. The fines were received from the conversion agent and no chemical analysis was done by third party on the coke supplied. Further, though coke supplied by other parties was with ash percentage of 28.28 to 29.83, payment was released restricting ash content to 27 *per cent* as per terms of purchase order. However, in case of UML, though the ash content was 26.94 to 33.77 *per cent*, there was no provision towards reduction of high ash content. In the subsequent period from July 2005 onwards the Company received coke from UML with ash content upto 27.48 to 38.95 *per cent*.

Loss due to higher ash and lower fixed carbon

Receipt of coke having higher ash content than envisaged in the agreement resulted in loss of Rs. 2.21 crore during 2005-08.

2.2.33 As per terms of work order with UML in March 2005, UML was to supply the converted coke with ash content as per actual in consideration of the input percentage of ash and volatile material in the coal supplied by the Company. But the coke received from UML contained higher ash percentage ranging from 2 to 3 than the terms of agreement as a result of which the Company had to incur loss of Rs. 2.21 crore on purchase of 1,21,240 MT of coke during 2005-08.

Government stated (September 2008) that required coal was not provided as per work order for which there was deviation in the coke produced by UML. The reply is not acceptable as loss has been computed on the basis of conversion norm adopted in the agreement on the quality of coal actually supplied and coke received.

Excess generation of fines in coke from joint venture coke oven plant

The Company incurred loss of Rs. 2.14 crore due to generation of excess fines over the norm.

2.2.34 The requirement of coke size of the plant was of 25 to 50 mm. The work order on UML for conversion, however, did not define the size of the coke to be supplied. The plant level committee of the Company decided (December 2004) for acceptance of five *per cent* undersize coke from UML. As per the terms of the work orders, the converted coke was to be analysed by a third party for payment of bills. During April 2005 to 7 May 2006, size analysis was not made for coke supplied by UML. From the subsequent size analysis made against 68,486 MT of coke supplied by UML during 8 May 2006 to 7 February 2008, it was evident that there was generation of 3,082 MT of fines in excess of norms resulting in loss of Rs. 2.14 crore.

Government stated (September 2008) that due to breaking of oversize coke by the Company, the fines proportion was increased. The reply is not acceptable as the under size coke (fines) pointed out in audit was taken from the test reports attached with supply bills.

Supply of oversized coke

Receipt of oversized coke than stipulated in the agreement resulted in loss of Rs. 3.15 crore.

2.2.35 As per agreement with the joint venture partner, UML was required to supply coke with size up to 150 mm. UML supplied 34,135 MT of oversized coke above 150 mm out of total supply of 68,486 MT during 8 May 2006 to 7 February 2008 violating the provisions of the agreement. As a result, the Company had to incur extra expenditure of Rs. 0.39 crore to bring the oversized coke to the required size. Further, 4,044 MT of fines were generated during breaking of oversize material which were sold at a nominal price ranging from Rs. 111 to Rs. 230 per MT and in the process the Company sustained loss of Rs. 2.76 crore.

Government stated (September 2008) that though coke upto 150 mm size was not required by the Company the same was fixed assuming that the coke oven plant would produce upto that size. The fact is that the receipt of coke as per terms of the agreement was not ensured.

Marketing of pig iron

2.2.36 Pig iron produced by the Company has high demand in the market. The Company produced 6.04 lakh MT of graded pig iron during 2003-08 and sold 5.94 lakh MT and the sale ranged from 96 to 100 *per cent* of the production during 2003-08.

Sales performance

2.2.37 The budgeted production and sales to the actual sales are detailed below:

Year	Production of cold metal		Budgeted sales	Actual sales	Achievement with respect to budget
	Budgeted	Actual			
	Million tonne				(*per cent*)
2003-04	1.57	1.35	1.57	1.34	85
2004-05	0.58	0.96	0.58	0.97	167
2005-06	1.60	1.23	1.60	1.20	75
2006-07	1.43	1.42	1.43	1.42	99
2007-08	1.72	1.44	1.72	1.38	80
Total	**6.90**	**6.40**	**6.90**	**6.31**	

It would be seen from the above that except in the year 2004-05 the Company could not achieve the budgeted targets. Sales in the year 2004-05 was achieved as production was more than the budget. Non-achievement of sales target was due to non-achievement of production target.

Price fixation

Sale of pig iron below the market price/ tender price resulted in loss of Rs. 4.38 crore.

2.2.38 The sale activities cover ex-work sale from the plant to northern region as well as inside the state. Besides this, the Company sells pig iron from the stockyard at Kolkata through stock transfer. The price of pig iron for ex-plant sale is fixed through limited tender. For the stockyard at Kolkata, the stocks are being transferred at a provisional price. Actual sales at Kolkata stockyard are made through negotiation. The sales price is finalised by a committee and approved by MD. Individual transactions were reviewed during the course of audit wherein it was observed that the Company had sold 29,987 MT of pig iron below market/tender price resulting in loss of Rs. 4.38 crore as detailed in **Annexure 15**.

Audit observed the following:

- In northern region, 4,685 MT of pig iron was sold on ex-works basis at a lower rate than the prevailing price in Kolkata.

- From Kolkata stockyard 9,828 MT of pig iron was sold on negotiation basis at a price lower than ex-works sale price of northern region.

- Without obtaining full advance, 9,241 MT of pig iron was sold to customers on ex-work basis. The customers booked material by paying token advance. On the date of dispatch, however, there was increase in price and the increased price was not applied to them.

- At negotiated rate, 6,233 MT of pig iron was sold on ex-work basis which was lower than the tender rate.

Government stated (September 2008) that as per the recent pricing policy the price ruling on the date of dispatch is applicable and recently they had introduced tendering system in Kolkata. It was further stated that pricing decision was taken on the basis of landed cost of pig iron. The fact remains that the financial interests were not safeguarded during sale of the above mentioned material. Further, though the landed cost to customers in northern region was more than that in Kolkata still the ex-work realisation to the Company was more from the sales in the northern region.

Payment of demurrage charges

The Company failed to collect demurrage charges of Rs. 1.20 crore from the contractor as per terms of the agreement.

2.2.39 Rakes are indented from Railway authorities for sale of pig iron and placed on the sidings for loading. The Company was required to pay demurrage charges for delay in loading wagons beyond free time of nine hours allowed by the railways. During 2003-08, the Company paid Rs. 1.20 crore towards demurrage charges to Railway authorities due to delay in loading of pig iron in rakes. As per the terms of agreement, the contractor[Ψ] had to deploy sufficient number of labourers to complete the loading within permissible time. The demurrage amount paid to Railway authorities for delay, if any, was to be recovered from the contractor. The delay in loading was attributable to insufficient deployment of manpower by the contractor. No recovery was made from the contractor for the delay.

Government stated (September 2008) that the existing labourers engaged for loading belong to recognised unions and the contractor could not change them and their working hours. Hence, the demurrage charges due to delay in loading, was borne by the Company. However, the Company should have acted as per terms of the agreement with the contractor.

Additional sales tax liability due to non-collection of requisite form

Non-collection of Form-C and Form-12 from the buyers resulted in avoidable burden of Rs. 1.95 crore towards sales tax liability during 2003-06.

2.2.40 As per Section 8 of Central Sales Tax Act (CST), 1956, the seller must collect declaration under Form-C for effecting sales to outside state on concessional tax basis. Similarly for exempted sale/concessional sale within West Bengal the seller has to collect Form-12. Though the Company made sales during 2003-06 amounting to Rs. 26.84 crore in the plant on concessional tax basis, it did not collect the Form-C from the customers as required under the provisions of the CST. As per the assessment order (December 2007 and July 2008) the Company had to bear sales tax liability of Rs. 1.60 crore. Similarly, the Company made sales of Rs. 6.90 crore on sales tax exemption basis and sales of Rs. 7.22 crore on concessional tax basis to customers of the stockyard at Kolkata during the year 2004-05 without collection of Form-12 and had to bear tax liability of Rs. 34.91 lakh.

Government stated (September 2008) that Form-12 in respect of stockyard sales had been collected and would be produced to the Sales Tax authority. The reply was, however, silent about collection of the Form-C in respect of sales inside Orissa. The fact remains that the Company has not devised a system to collect required forms at the time of sale.

[Ψ] Mahima Enterprises, Keonjhar.

Payment of loading charges on the sale of pig iron from plant

Due to non-recovery of loading charges in the sale of pig iron the Company sustained loss of Rs. 1.50 crore.

2.2.41 During 2003-08 (upto February 2008) the Company sold 5.33 lakh MT of pig iron on ex-works/ex-factory basis and incurred Rs. 1.50 crore towards loading of pig iron into rakes/trucks through its contractor. The above amount should have been recovered from the parties as loading activities do not form a part of ex-works sale.

Government stated (September 2008) that in ex-plant price, loading of material into trucks/wagons was to the accounts of the seller. The reply is not tenable since ex-plant price as per commercial practices followed by commercial organisations does not include loading cost and no mention was made in the sale order/tender that the seller would bear the cost.

Internal control and internal audit

Internal control

2.2.42 Internal control is a management tool to ensure that the management's objectives are achieved in an effective and orderly manner. The following deficiencies were noticed in the internal control system:

- The Company has not prepared manuals and guidelines in respect of activities like purchase, production, storage, sales, accounting etc.

- The MD is the Chief Executive of the Company but all decision making powers lie with the Chairman. Thus, there was no delegation of power to the MD to carry out the day-to-day business of the Company.

- There was no system of identification, declaration, adjustment/ disposal of unused/obsolete/ unserviceable and non-moving items of stores and spares. As on 31 March 2008, non-moving store items worth Rs. 2.20 crore were lying undisposed.

- There was no system of maintaining stock of granulated slag generated from the plants. Considering production of 5.95 lakh MT of hot metal during 2003-08 (October 2007), production of slag should be 2.08 lakh MT as per norm of 35 *per cent*. The Company, however, sold only 1.55 lakh MT during the above period. As no physical verification had been conducted, actual availability of stock or loss on production of slag, if any, could not be verified for an estimated stock of around 53,000 MT.

While accepting the audit findings, Government stated (September 2008) that manuals for production, stores, sales etc. were not available and identification of non-moving items of stores and spares was in process. It added that it did not maintain stock position of slag due to its low value.

Internal audit

2.2.43 The Company did not have own internal audit wing. The internal audit was entrusted to a firm of Chartered Accountants from 2004-05 onwards. The scope, *inter alia*, included pre-audit of almost all transactions and preparation of compliance reports to the audit. The Company constituted (May 2005) Board Level Audit Committee, which held only seven meetings during the last four years ending 31 March 2008. Thus, the meetings of the audit committee were not held at regular intervals to review internal audit queries and their compliance.

Deficiencies in pollution control

2.2.44 Central Pollution Control Board has categorised Pig Iron Industries as high polluting type because of their high pollution potential. The major source of water pollution is the discharge of industrial wastewater due to cleaning of iron ore before feeding to the furnace. Air pollution is caused due to emission from the BF chimney. The relevant pollutants are Suspended Particulate Matters (SPM) and carbon monoxide (CO) etc. The following deficiencies in pollution control by the Company were noticed:

- The discharge of effluent did not comply with the stipulated standard. State Pollution Control Board instructed (February 2004) to install Belt Press Filter/Vacuum Filter to remove the solids from the clarifier underflow before it is discharged to the river so that effluent discharged can comply with the prescribed norms. The Company failed to take up the desiltation work of the lagoons to augment their efficacy.

- There was no cover shed for storing coke and coal besides inadequate number of water sprinkling nozzles in coal/coke handling area to suppress fugitive dust.

- No pollution control measures were adopted in the induction arc furnace to prevent fugitive emission generated from the furnace and the particulate matter emission from the stack attached to the Air Pollution Control system.

- Carbon monoxide is a poisonous gas generated in the BF and used for generation of power. Adequate number of carbon monoxide detectors along with alarms were not installed at different strategic points in the BF, boiler house and gas cleaning plant area with relay system from control room.

- Adequate measures were not taken for plantation and maintaining the green belt around the factory area.

Government while accepting the audit findings stated (September 2008) that action was being taken to clean the lagoons through tendering and for plying water containers in truck with sprinkling pipe line inside the plant and for procuring one carbon monoxide detector in addition to the existing one.

Acknowledgement

Audit acknowledges the co-operation and assistance extended by the Management and staff of the Company at various stages of conducting the Performance Audit.

Conclusion

Though the Company spent Rs. 22.56 crore on modernisation scheme, the production virtually remained at the level of pre-modernisation period due to non-operation of all the BFs. The recommendation of MECON of February 2004 to enhance the production capacity at the cost of Rs. 31 crore was not implemented by the Company which resulted in low capacity utilisation, excess consumption of coke and electricity, besides generation of low graded pig iron. The Company also did not adhere to the recommendation of the BoD for taking up relining work, which resulted in shut down of the plant for 25,920 hours during the five years ending 2007-08. There was avoidable expenditure on unplanned procurement of coke. Absence of marketing strategy and sale below market price also added to the loss of the Company. There were deficiencies in the internal control system and pollution control measures also.

Recommendations

The Company should consider:

- **Implementing the proposal submitted by MECON for restoration of health of the plant to augment the production capacity to the optimum level.**
- **Relining of BFs on time with proper planning.**
- **Formulating a sales policy.**
- **Strengthening the internal control system.**
- **Adhering to the pollution control norms strictly.**

Industrial Promotion and Investment Corporation of Orissa Limited

2.3 Recovery of loans

Highlights

Targets fixed by the Company for recovery of loans were very low and ranged between 9.60 and 16.83 *per cent* of net demand; despite this the Company failed to achieve the same, as total recovery to net demand was from 7.46 to 13.51 *per cent* during 2003-07.

(Paragraph 2.3.8)

Non-performing assets, which were 70.08 *per cent* (Rs. 69.31 crore) in 2003-04 further increased to 78.25 *per cent* (Rs. 55.75 crore) in 2006-07 despite Board of Directors' decision to reduce them to 50 *per cent* by 31 March 2006.

(Paragraph 2.3.9)

Inadequate monitoring of defaulting borrowers resulted in non-recovery of overdues of Rs. 51.96 crore from 32 defaulting units.

(Paragraph 2.3.11)

One Time Settlement schemes finalised by the Company were neither consistent with the RBI guidelines nor in the best interest of the Company which resulted in settlement of dues, foregoing Rs. 18.75 crore in 23 cases.

(Paragraph 2.3.14)

The Company failed to take timely action for seizure and disposal under Section 29 of the SFCs Act as a result of which dues amounting to Rs. 143.39 crore relating to 106 units remained unrealised.

(Paragraph 2.3.20)

The Company failed to file suits under Section 31 of the SFCs Act for realisation of shortfall amount of Rs. 49.59 crore which arose due to seizure and sale of assets from 54 units under Section 29 of the SFCs Act.

(Paragraph 2.3.21)

There were deficiencies in the monitoring mechanism and management information system.

(Paragraph 2.3.23)

Introduction

2.3.1 Industrial Promotion and Investment Corporation of Orissa Limited (Company) was incorporated (April 1973) as a wholly owned Government Company with the main objective of promoting large and medium scale industries in the State by providing financial and technical assistance for establishing new industrial units as well as expansion, diversification and modernisation of existing units. The Government of Orissa (GoO) designated (March 2005) the Company as the State Level Nodal Agency (SLNA) to render assistance and feedback in policy formulation for industrial progress as well as guide and assist entrepreneurs to set up industries in the State. The Company disbursed loans of Rs. 242.23 crore to 292 units since inception till August 2006 and there was no disbursement thereafter.

The management of the Company is vested in a Board of Directors (BoD). The Managing Director (MD) is the only functional director and the Chief Executive who is assisted by an Executive Director (ED), a Chief General Manager, four General Managers (GM) and two Deputy General Managers (DGM).

A review on the recovery performance of the Company was included in the Report of the Comptroller and Auditor General of India (Commercial) for the year ended 31 March 2000, Government of Orissa. The Committee on Public Undertakings (COPU) discussed the Audit Report in July 2008 and their recommendations are awaited (August 2008). Subsequently, a Performance Audit on the Internal Control System and Internal Audit was included in the Report of the Comptroller and Auditor General of India (Commercial) for the year ended 31 March 2005, Government of Orissa, which is yet to be discussed (August 2008) by the COPU.

Scope of Audit

2.3.2 The present Performance review conducted during November 2007 to March 2008 covered the recovery of loans during 2003-08. Out of 218 units (outstanding amount of Rs. 202.26 crore) having unsettled accounts with the Company during 2003-08, records of 77 units (outstanding amount of Rs. 117.93 crore) were selected and examined in audit. The selection was based on the status of repayment by the loanees, magnitude of the loans and the period of default.

Audit objectives

2.3.3 The Performance Audit was conducted with a view to assess whether:

- the terms and conditions adopted for sanction of loan and its recovery were adequate to safeguard the financial interest of the Company and these were followed by the Management without any deviation;

- there existed a system of examining the credit worthiness of the loanees and to identify habitual defaulters by exchanging list of defaulters of other state financing agencies/banks for consideration before sanction of loans;

- timely and effective action had been taken for recovery of loans in adherence to the available legal framework by fixing realistic targets and monitoring its achievement; and

- schemes for One Time Settlement (OTS) of loans were implemented efficiently and effectively in a transparent manner.

Audit criteria

2.3.4 The audit criteria adopted for assessing the achievement of the audit objectives were:

- terms and conditions, guidelines/procedures for sanction and recovery of loans;

- targets for recovery of dues and achievement thereof;

- provisions in State Financial Corporations (SFCs) Act, 1951, Orissa Public Demands Recovery (OPDR) Act and general financial procedures and rules; and

- the guidelines of the Government, Reserve Bank of India (RBI) and Industrial Development Bank of India (IDBI)/Small Industries Development Bank of India (SIDBI), decisions of the Board of Directors, executive instructions, etc. towards demand, monitoring and realisation of dues and its compliance.

Audit methodology

2.3.5 The audit methodologies adopted for achieving the audit objectives with reference to audit criteria were:

- examination of records relating to various loanees, system for fixing of targets, achievements vis-à-vis targets and periodical reports on recovery;

- examination of agenda and minutes of the Board of Directors, internal committees, loan ledgers, demand notices, policy on one time settlements, provisions, write-off, classification of loan assets, seizure and disposal of defaulting units, correspondence with the borrowers, IDBI/SIDBI, GoO and other agencies; and

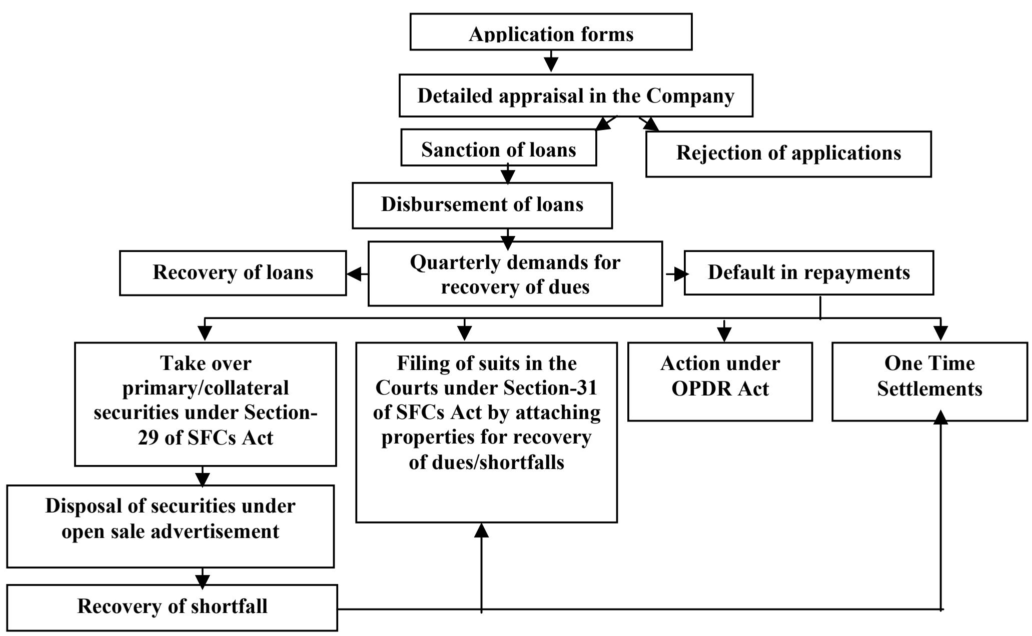
- interaction with the Management and issue of audit queries.

Audit findings

The audit findings as a result of performance audit were reported (April 2008) to the Company/Government and discussed (4 August 2008) in the meeting of the Audit Review Committee for State Public Sector Enterprises (ARCPSE). The meeting was attended by the Commissioner-cum-Secretary, Department of Industries, GoO and Managing Director of the Company and their views have been taken into consideration while finalising the report. The audit findings have been discussed in the succeeding paragraphs.

Procedure for financial assistance and recovery

2.3.6 The Company sanctions loans upto Rupees five crore towards Term Loan (TL) and Rs. 60 lakh towards Short Term Loan (STL). The prospective entrepreneur seeking financial assistance is required to present a project proposal to the Business Promotion and Co-ordination Cell (BPCC) of the Company. If the project is *prima facie* acceptable to BPCC, the entrepreneur along with relevant documents appears before the Internal Advisory Committee (IAC). Thereafter, a detailed appraisal memorandum covering the technical aspects, market study and financial analysis is placed before BoD, which sanctions the loan. After execution of the agreement, disbursements are made against the assets created by the promoter and valued by the Company. The TL is repayable in four to ten years including a two and a half year moratorium and STL is repayable in six months. The process of sanction, disbursement and recovery of loan is shown in the following flow chart.



The Company also allows deferred loans (DL) to the buyers, who purchase the primary/collateral securities auctioned by the Company to realise its dues. After receiving down payment, balance sale proceeds is treated as loan to the buyer payable in instalments together with interest as fixed by the Company.

Disbursement of loans

Targets vis-à-vis achievements of loan disbursement

2.3.7 The Company stopped sanction of loans from 2006-07. The disbursement of loans during 2003-07 was Rs. 22.29 crore against the target of Rs. 53.50 crore. Audit noticed deficiencies in sanction and disbursement of loans in four out of 20 cases of disbursement during 2003-07, as stated below:

- The Company disbursed (May 2004 to April 2005) Rs. 37.22 lakh to Mindslot Networks (P) Limited though refinance was not available from SIDBI and IDBI on the ground that loan to small size call centres were to be avoided in view of prevailing market scenario and competition in IT sector. Considering the collateral security of Rs. 6.45 lakh and overdue amount of Rs. 49.31 lakh including interest of Rs. 15.81 lakh as of May 2008, there is likely loss of Rs. 42.86 lakh. Government stated (September 2008) that OTS proposal was under consideration for realisation of dues. The fact remains that the loan was disbursed without availing refinance and ignoring the views of SIDBI/IDBI as a result of which the loan became overdue since February 2005.

- Though term loan of Rs. 47.50 lakh was disbursed (April 2006) to Tatwa Technologies (P) Limited (TTPL) for five years, collateral security in the form of bank guarantee (BG) for Rs. 11 lakh was obtained for one year only. The loan became unsecured due to expiry of BG in March 2007 and outstanding remained at Rs. 41.42 lakh including overdue amount of Rs. 5.56 lakh (May 2008). Government stated (September 2008) that TTPL gave an undertaking to renew/replace the BG. The fact remains that the Company neither obtained BG for five years period, nor initiated action for recovery of the loan.

- Loan of Rs. 2.50 crore was disbursed (2004-05) to Ores Ispat (P) Limited which was in default since November 2006, even after rephasement (August 2006). Prompt action for recovery was not taken which resulted in outstanding of Rs. 3.47 crore including overdue interest of Rs. 0.97 crore (May 2008). Government stated (September 2008) that when recall notice was issued in March 2008, the unit obtained a directive from High Court of Orissa not to take coercive action. The fact remains that the Company neither encashed collateral security of fixed deposits of Rs. 50 lakh, nor took prompt legal action to realise its dues which became overdue since November 2006.

- Additional loan of Rs. 92.80 lakh was disbursed (2003-05) to Magnum Fibres (P) Limited. Due to default and at the requests of the unit, rephasements were allowed in February 2004 and October 2005. Despite this, the unit was in default since February 2007. In view of the value of net fixed assets at Rs. 85.25 lakh (March 2007) as against outstanding of Rs. 141.41 lakh including overdues (Rs. 45.93 lakh) as of May 2008, there is likely loss of Rs. 56.16 lakh. Government stated (September 2008) that market value of fixed assets as per valuation in July 2007 was Rs. 514.76 lakh and thus there was adequate security. However, in spite of default and having adequate security, no recovery action was taken to realise the dues.

Deficiencies in disbursement of loans resulted in non-realisation of overdues of Rs. 1.98 crore and foregoing of Rs. 1.54 crore.

These deficiencies have led to non-realisation of dues of Rs. 5.79 crore including overdues of Rs. 1.98 crore in four cases.

Further, loan of Rs. 2.75 crore was disbursed (October 1998 to August 2000) to BDA Nicco Parks and Resorts Limited for its amusement park, against the collateral security of land in spite of knowing that it had only user rights. Hence, the Company had to accept (November 2007) the OTS proposal for Rupees three crore as offered by the unit, as against the dues of Rs. 4.54 crore after foregoing Rs. 1.54 crore. Government stated (September 2008) that the loan was disbursed as per State Government directive and OTS was approved for negotiated amount of Rupees three crore. The reply is not tenable since despite knowing the risks involved in the business of an amusement park, disbursement of loan without proper collateral security proved to be imprudent.

Recovery of loans

Targets vis-à-vis achievements for recovery of loan

2.3.8 Quarterly demands are raised for recovery of dues from the loanee units in February, May, August and November every year. Project Divisions headed by ED, GM and DGM are responsible for monitoring from sanction of loan till the final recovery. After disbursement of loans, they are required to inspect the units twice during the year to follow up the recovery. In case of default in repayments, show cause notices are issued followed by notices recalling the entire outstanding dues and take over of the assets under Section 29 of SFCs Act, 1951 for eventual sale/transfer through auction/negotiation. Further, the Company may also recover the entire dues through OPDR Act, 1962 from the defaulting units. If the sale proceeds fall short of total dues of the respective units, to realise the same, action is resorted to against the defaulting borrowers/ guarantors/ promoters invoking collateral securities/ personal guarantees under Section 31 of SFCs Act, 1951. The Company, however, did not have a system of exchanging information regarding defaulters of loans with other financing companies/ banks. It also did not take the help of the website of Credit Information Bureau (India) Limited and RBI who keep the data relating to suit-filed and non-suit-filed defaulting units respectively.

The Company fixes targets for recovery of loans in its annual budgets for internal resources mobilisation. Targets are fixed taking into account repayments due from standard units and expected recoveries from defaulted units on resorting to rephasements, disposal of seized assets and settlement of dues under OTS. The details of total dues for recovery, targets fixed and actual recoveries during 2003-08 are given in the table below:

Sl. No.	Particulars	2003-04	2004-05	2005-06	2006-07	2007-08
	Net realisable demand[$]	*(Amount: Rupees in crore)*				
1.	Arrear demand	127.70	136.90	140.15	146.95	NA
2.	Current demand	33.98	29.48	26.79	35.25	NA
3.	Total net demand (1+2)	161.68	166.38	166.94	182.20	NA
4.	Total targeted recovery	26.50	28.00	22.00	17.50	13.75
	Recovery against					
5.	Arrear demand	4.47	7.22	3.52	2.92	NA
6.	Current demand	17.38	14.88	15.82	10.68	NA
7.	Total actual recovery (5+6)	21.85	22.10	19.34	13.60	15.34
	Percentage of actual recovery against					
8.	Targets (7/4)	82.45	78.93	87.91	77.71	--
9.	Total net demand (7/3)	13.51	13.28	11.59	7.46	--
	Percentage of targeted recovery against					
10.	Net demand (4/3)	16.39	16.83	13.18	9.60	--

Note: Figures for 2007-08 are not available due to non-finalisation of accounts

It would be seen that:

The Company failed to achieve the recovery targets despite fixation of low targets.

- the percentage of recovery targets fixed with reference to net demand ranged from 9.60 to 16.83 and actual recovery to net demand was between 7.46 and 13.51. In spite of low targets, the Company failed to achieve the same;
- targets for recovery were decreasing while net due for recovery was increasing reflecting that targets did not aim for maximising recovery;
- no separate targets against arrear and current dues were fixed;
- annual targets required to be finalised before commencement of financial year, were finalised between June and September of the financial year defeating the very purpose of fixation of targets;
- targeted recovery of Rs. 17.50 crore during 2006-07, against net realisable demand of Rs. 182.20 crore indicated that the Company had remote chances of realisation of major portion of loan of which 78.25 *per cent* was NPA.

Government stated (September 2008) that targets were fixed after assessing the possibility of realisation from the running units and recovery targets could not be achieved mainly due to increase in NPA accounts due to sickness of assisted units. Thus, despite fixing low targets, the same could not be achieved.

[$] Constitutes arrears at the beginning of the year *plus* amount fell during the year *minus* amount rescheduled/waived.

Performing and non-performing loans

2.3.9 In terms of guidelines of Reserve Bank of India (RBI), as modified from time to time, the loan portfolio was classified into four categories i.e. standard[#], sub-standard[*], doubtful[&] and loss[@] assets considering the prospect and period of default in realisation. Standard assets are considered as performing assets. The sub-standard and doubtful assets together are called "Non Performing Assets" (NPA). The details of class-wise loan assets of the Company during 2003-07 are indicated below:

Year	Total principal outstanding (Rs. in crore)	Standard assets (Rs. in crore)	No. of standard units	Non-performing assets (Rs. in crore)			No. of NPA units	Percentage of NPA to total outstanding	Loss assets written off (Rs. in crore)
				Sub-standard	Doubtful	Total			
2003-04	98.89	29.58	29	17.05	52.26	69.31	109	70.08	0.00
2004-05	88.20	24.17	24	15.84	48.19	64.03	107	72.60	1.38
2005-06	80.43	17.82	15	8.02	54.59[$]	62.61	102	77.84	0.53
2006-07	71.25	15.50	16	0.81	54.94	55.75	92	78.25	1.31
2007-08	Accounts not finalised								
[$] Doubtful assets include Rs. 0.14 crore towards loss asset not written off.									

Non-performing assets, which were 70.08 *per cent* (Rs. 69.31 crore) in 2003-04 further increased to 78.25 *per cent* (Rs. 55.75 crore) in 2006-07.

It would be seen that there were 29 standard units (Rs. 29.58 crore) at the end of March 2004, which decreased to 16 units (Rs. 15.50 crore) at the end of March 2007. The percentage of NPA to total outstanding increased from 70.08 to 78.25 during 2003-07. As per the Memorandum for the Cabinet prepared by the Industries Department in respect of Restructuring plan of the Company, the higher percentage of NPA was attributed to promotion of industries in backward areas, term loan assistance on liberal norms and management problems associated with first generation of entrepreneurs, inadequate working capital, poor marketing outreach etc.

Audit scrutiny revealed that improper documentation work (refer to paragraph 2.3.7), absence of appropriate recovery measures (refer to paragraphs 2.3.11 to 2.3.13, 2.3.20 and 2.3.22) and absence of system for physical verification of assets of assisted units (refer to paragraph 2.3.23) were also the reasons for reduction in performing assets. Further, as per terms of sanction, the assisted units are required to take necessary insurance policy to the satisfaction of the Company. The Company, however, did not monitor the renewal of insurance policy after disbursement of loans, which also contributed to increase in NPA. As a result of this, total provision towards doubtful loans made by the end of March 2007 was Rs. 23.02 crore, which was 32.31 *per cent* of the principal outstanding of Rs. 71.25 crore. Though the BoD decided (June 2005) to

[#] The assets in respect of which there is no default in repayment of principal or payment of interest.
[*] The assets in respect of which loan or interest remain overdue for more than six months but not exceeding 18 months.
[&] Sub-standard assets remain overdue for periods exceeding 18 months.
[@] The assets in respect of which the loan is identified as loss asset not recoverable and not written off.

reduce the NPA to 50 *per cent* through recovery measures by 31 March 2006, no effective action was taken in this regard.

Government accepted (September 2008) that the main reasons for increase in NPA was due to non-recovery from suit filed as well as seized cases and spiraling effect of charging interest on overdue amount. It was also added that decrease in standard loans due to repayment was also the cause of increase in NPA. But the fact remains that the Company failed to achieve the targets for recovery during 2003-08 as discussed in paragraph 2.3.8.

Deficiencies in recovery performance

Non-issue of demand notices to defaulting borrowers

2.3.10 The Company issues quarterly demand notices (May, August, November and February) to borrowers with a request to make timely payment. As of March 2003, loan accounts of 211 units involving Rs. 195.25 crore were pending realisation. By March 2007, dues amounting to Rs. 201.53 crore from 177 units were pending. The details of demands issued to loanee units during May 2003 to February 2008 were as follows:

Details	April 2003	April 2004	April 2005	April 2006	April 2007
	Number of units				
Number of units from which dues pending	211	200	193	181	177
Number of units for which quarterly demand notices issued in					
May	71	NA	51	33	29
August	81	57	43	28	28
November	57	59	51	28	26
February	74	59	40	27	23

It would be seen from the above that demand notices were issued to 23 to 81 units against 177 to 211 units from which the realisation was outstanding, which indicates a serious deficiency in the first step in recovery mechanism.

Government stated (September 2008) that as a practice, demand notices are not issued to units seized under Section 29 and referred to Board for Industrial and Financial Reconstruction (BIFR). However, only 19 units were referred to BIFR, hence demand notices should have been issued to other units. During ARCPSE meeting the Management accepted to issue demand notices to all the units.

Inadequate monitoring of defaulting borrowers

2.3.11 In order to check default cases and to improve recovery performance, proper monitoring and pursuance with defaulting units is required. Audit observed that in spite of continued default in 92 NPA cases as of March 2007, except issuing demand notices to some units, no further action as per laid down procedures was initiated in 32 cases involving outstanding of Rs. 63.34 crore including overdue amount of Rs. 51.96 crore as of May 2008. The details are shown in **Annexure 16**. Audit scrutiny revealed that no

Inadequate monitoring of defaulting borrowers resulted in non-realisation of overdues of Rs. 51.96 crore.

payments were received at all in 10 cases, no repayments were received towards principal loan in six cases, part payments were received in eight cases and OTS failed in eight cases. In spite of continued default and increase in overdues year after year, the Company did not initiate recovery measures as per procedure mentioned in paragraph 2.3.8, which indicates inadequate monitoring resulting in non-recovery of overdues of Rs. 51.96 crore.

2.3.12 The Company disbursed (November 2001 to March 2002) loan of Rs. 2.50 crore to Cosboard Industries Limited (CIL) for its writing, printing and newspaper project to be repaid within six and a half years with interest. CIL paid Rs. 19.64 lakh only towards interest till March 2004. Though rephasement of the loan was made in July 2004, no payment was made by the unit. By the time the Company issued recall notice (5 October 2004) for recovery of the loan of Rs. 3.48 crore as per direction of the Board, CIL had applied (4 October 2004) to BIFR for declaring the unit as sick which is still pending with BIFR for final orders. As of May 2008, total outstanding against CIL was Rs. 4.92 crore.

Audit scrutiny revealed that:

Sanction of loan to a unit with poor financial health coupled with poor recovery led to non-realisation of Rs. 4.92 crore.

- The Company was aware that the super cyclone of October 1999 had damaged the plant of the loanee. In spite of poor credit worthiness and financial health, it disbursed loan to the unit and rephased the loan in July 2004.

- Though the disbursement letter stipulated (November 2001) moratorium of six months and repayment in 24 quarterly instalments, the demand for first instalment of principal was raised only in November 2003 after a lapse of 18 months from the stipulated period (May 2002).

- In spite of CIL being a chronic defaulter, recall notice was issued in October 2004 after a delay of two years from the stipulated period.

Government while accepting poor financial position of CIL for default in repayment of dues stated (September 2008) that necessary action would be taken for recovery of dues after BIFR order is passed. Thus, sanction of loan to a unit with poor financial health coupled with poor recovery performance resulted in non-realisation of Rs. 4.92 crore (May 2008).

Rephasement/restructuring of overdue loans

2.3.13 The defaulter units generally seek rephasement of loans due to their inability to repay the loan dues. The Company allows rephasement by converting overdue interest (ODI) into funded interest (capitalised interest) and by revising the original schedule for repayment of principal in order to improve the recovery. During 2003-07, the Company approved such rephasement in respect of eight units covering principal loan of Rs. 8.64 crore and conversion of overdue interest of Rs. 2.53 crore into funded interest (FI).

Audit observed that the Company neither fixed any norm for eligibility of the units to avail rephasement, nor ensured any assurance from the units to pay the dues as per the revised schedules. As a result all the eight units failed to comply with the revised schedules of rephasement and overdues continued. After further rephasement, one unit became standard, three units settled the dues under OTS. Default continued by four units, of which assets of one unit were seized (July 2006). Thus, no action for recovery of overdues of Rs. 1.05 crore (May 2008) was taken. Some instances where rephasement was not in the interest of the Company are discussed below:

- Bimala Projects (P) Limited failed in making repayments as per the earlier rephasement in June 2002, but further rephasement was approved in March 2005 for repayment of outstanding loan and FI within nine years. Default by the unit continued in spite of further rephasement. The unit, however, opted (March 2006) for OTS, which was approved (December 2006) and settled at Rs. 1.61 crore restricting to value of securities against total dues of Rs. 2.23 crore. Audit observed that approval for long-term rephasement upto nine years was not in the interest of the Company, when OTS scheme was in operation and the unit was NPA as of March 2004. The Company should have insisted for OTS to realise the then dues of Rs. 1.87 crore, when the value of securities was Rs. 2.24 crore. Due to delayed decision (December 2006) for OTS, the dues increased to Rs. 2.23 crore (May 2006) whereas the value of securities reduced to Rs. 1.61 crore on account of depreciation of assets. As a result the Company had to forego Rs. 0.62 crore and recovered the OTS amounts after 21 months.

Government stated (September 2008) that in spite of several attempts, the revenue generation of the unit was not sufficient for which the loan was finalised under OTS. However, the Company should have insisted for OTS in March 2005 instead of rephasement for realisation of better amount before 21 months when the value of assets was more.

- The Company allowed deferred loan of Rs. 0.55 crore (being Company's share) to Lovely Agro Foods (P) Limited (LAFPL), which took over (March 1998) the assets of Universal Vita Elementere (P) Limited. The unit became NPA by March 2001. The rephasement was allowed (September 2003) with repayment of loan and FI within eight years. Due to continued default, assets were seized (July 2006) and decision for disposal at Rs. 30.50 lakh (Company's share) was taken (December 2007) which was not realised since the matter was subjudice (August 2008). Audit observed that when the unit did not respond to OTS communication in June 2002, the Company should have initiated action for recovery of dues (Rs. 0.93 crore being Company's share), instead of allowing rephasement in September 2003, which unnecessarily delayed the recovery action leading to non-recovery of Rs. 2.01 crore outstanding as of May 2008.

The Company failed to evolve criteria ensuring the repayment in case of rephasement of loan, which resulted in defeating the objective of rephasement.

Government stated (September 2008) that since the matter was subjudice the sale could not be effected. The fact remained that the decision for rephasement in September 2003 was not in the interest of the Company and subsequent seizure of the unit was at the request (September 2005) of LAFPL after theft (July 2005) of machineries worth Rs. 3.09 crore from the unit.

Thus, the Company's failure to evolve criteria ensuring the repayment in case of rephasement of loan resulted in defeating the objective of rephasement.

One Time Settlement schemes

2.3.14 The RBI issued (July 2000) guidelines to commercial banks for recovery of dues from loans (Non-Performing Assets). Other State financial institutions like Andhra Pradesh State Financial Corporation, Orissa State Financial Corporation (OSFC) and State Industrial Development Corporations of Karnataka, Maharashtra and Andhra Pradesh adopted the policy and formula laid down in the above guidelines. In order to settle the outstanding dues, the Company also formulated (April 2002) One Time Settlement (OTS) scheme in line with the guidelines of RBI. Subsequently, the Company adopted (November 2003) modified schemes in contravention of RBI guidelines. The salient features of the OTS schemes formulated by the Company during 2002-08 were as follows:

OTS Scheme and duration	Settlement formula	Applicability
OTS Scheme 2002 (Approved in April 2002) (Valid upto March 2003)	Minimum of 100 *per cent* outstanding loan *plus* interest till classified as doubtful plus other debits upto 31 March 2002 **or** 100 *per cent* loan and interest upto date of recall plus other debits upto 31 March 2002.	NPAs as on 31 March 2002, which became doubtful or loss as on 31 March 1999.
	Minimum of 100 *per cent* outstanding loan *plus* interest till classified as doubtful *plus* other debits upto 31 March 2002 **or** 100 *per cent* loan and interest upto date of recall *plus* other debits upto 31 March 2002, *plus* simple interest from 15 February 1999 till approval.	NPAs as on 31 March 2002, which have been classified as sub-standard as on 31 March 1999 and became doubtful or loss subsequently.
	100 *per cent* outstanding loan *plus* interest *plus* unpaid debits *less* additional penal interest charged during the period in which the loan was irregular.	Other NPAs as on 31 March 2002.
OTS Scheme 2003 (Approved in November 2003) (Extended from time to time and valid upto March 2006)	Parameters of value of securities and formulae devised as stated below are considered for arriving at OTS amounts. If value of securities is higher, OTS amount is to be restricted to formula applicable to the situation. If value of securities is lower than loan outstanding, value of securities less provisions already made.	All NPAs.
OTS Scheme 2007 (Approved in September 2007) (valid upto March 2008)	Loan disbursed *plus* interest rate till cut off date i.e. 30 September 2003 (rate depends on the age of the loan) *less* repayments since inception to date of application or principal loan outstanding as on date of application, whichever is higher. (OSFC's scheme of OTS 2007 for loans beyond Rs. 50 lakh was the basis.)	Assets classified as doubtful/loss category as on 31 March 2007.

OTS schemes finalised by the Company were neither consistent with RBI guidelines nor in the best interest of the Company resulting in foregoing of Rs. 18.75 crore in 23 cases.

During 2002-08, 34 units having outstanding loans of Rs. 59.30 crore were approved for settlement at Rs. 26.71 crore which was 45.04 *per cent* of the outstanding loan, thereby foregoing Rs. 32.59 crore (principal Rs. 4.65 crore and interest Rs. 27.94 crore). Out of these 34 units, OTS in 10 cases did not materialise due to failure of these units to pay balance dues after paying partly Rs. 1.64 crore and one unit updated its accounts by paying the overdue amount. Balance 23 units finally settled their outstanding dues of Rs. 37.69 crore for Rs. 18.94 crore (50.25 *per cent)* resulting in foregoing of Rs. 18.75 crore. Thus, OTS schemes finalised by the Company were neither consistent with RBI guidelines nor in the best interest of the Company resulting in foregoing of Rs. 18.75 crore in 23 cases of which 11 cases are discussed in paragraph 2.3.16.

Audit observed that in line with RBI guidelines, IDBI/SIDBI insisted for payment of 100 *per cent* principal outstanding under OTS settlements for Rs. 45.11 crore and the Company could derive the benefit of Rs. 9.36 crore towards waiver of interest (Rs. 0.38 crore) and saving of interest payable (Rs. 8.98 crore) due to prepayment of principal, which was 21 *per cent* only. Whereas the Company finalised OTS with 34 NPA units, it had foregone 55 *per cent* of total outstanding inclusive of foregoing principal (Rs. 1.63 crore) in nine cases and funded interest (Rs. 3.02 crore) in 10 cases.

Government stated (September 2008) that the Company formulated its own policy in line with OTS policy adopted by various SFCs and Small Industrial Development Corporations. It further added that the amount sacrificed under OTS, which otherwise would have been considered as loss after some years, was definitely in the interest of the Company. Regarding settlement with SIDBI/IDBI by the Company in OTS, the MD stated in the ARCPSE meeting that the OTS scheme operated by the Company was not comparable with OTS finalised with SIDBI/IDBI.

The reply is not acceptable since the Company had to forgo more amounts under OTS besides foregoing some portion of principal and funded interest as discussed in paragraph 2.3.16. Further, though settlements under OTS scheme of the Company and that with SIDBI/IDBI were not related with each other, the level of amount foregone by the Company was comparatively higher than the benefit derived from OTS settled with SIDBI/IDBI.

Delay in scrutiny of applications

Delay in scrutiny of OTS applications resulted in loss of interest of Rs. 0.50 crore.

2.3.15 As per the OTS schemes operative during November 2003 to March 2008, scrutiny of applications was to be completed within 30 days from the date of receipt of applications. Audit scrutiny revealed that there were delays (September 2004 to November 2007) in communication of OTS approvals to those concerned ranging from 2 to 13 months in respect of 12 cases received during December 2003 to March 2007. The delayed scrutiny and communication of approval resulted in delayed realisation of funds of Rs. 16.11 crore from the units resulting in loss of interest of Rs. 50 lakh (considering prevailing interest rate between 4.75 and 9.5 *per cent* per annum).

Government accepted (September 2008) that there were delays in some cases due to delay in submission of papers and valuation of assets.

Settlement of OTS not in accordance with RBI guidelines

2.3.16 As per the settlement formula of RBI guidelines, the minimum amount that should be recovered under compromise settlement of NPAs would be 100 *per cent* of the outstanding balance in the account. Further, as per the OTS scheme approved in November 2003, limiting the settlement value to lower of outstanding dues and value of securities was not consistent with the RBI guidelines and was detrimental to the interests of the Company, as it allowed to forego even the principal loan and funded interest. Audit observed that in 11 cases settlement amounts were not sufficient to cover even entire principal and funded interest (FI) outstanding leaving aside the interest overdues as detailed in the table below:

(Amount: Rupees in lakh)

Name of the unit	Outstanding dues⊗			Value of securities	Amount settled under OTS	Amount foregone		
	Principal	Funded Interest	Total			Principal	Funded Interest	Settlement amount less than value of securities
Noble Pharma Care Limited	18.69	--	18.69	--	14.68	4.01	--	--
Bharat Agro Products & Finance Limited	43.26	--	43.26	--	41.47	1.79	--	--
Cold Forge (P) Limited	67.08	--	67.08	65.50	65.50	1.58	--	--
Sahu Gases Limited	51.00	28.00	79.00	--	15.00	36.00	28.00	--
Sakti Sugars Limited	289.97	--	289.97	225.00	216.08θ	73.89	--	--
Ashoka Industries Limited	58.50	--	58.50	--	23.48	35.02	--	--
Bimala Projects (P) Limited	133.55	57.29	190.84	160.71	160.50	--	30.13	0.21
TK International (P) Limited	89.96	42.60	132.56	159.43	100.45	--	--	58.98
BDA Nicco Parks and Resorts Limited	272.03	39.40	311.43	--	300.00	--	11.43	--
Puran Metal & Industries (P) Limited	15.33	--	15.33	16.13	15.33	--	--	0.80
Suburban Ply & Panels Limited	56.76	--	56.76	59.84	56.76	--	--	3.08
Total	**1096.13**	**167.29**	**1263.42**	**686.61**	**1009.25**	**152.29**	**69.56**	**63.07**

⊗ Outstanding dues exclude interest dues.

θ Though OTS was approved for Rs. 234.32 lakh, receipt of Rs. 216.08 lakh was treated as OTS amount and unrealised principal loan of Rs. 73.89 lakh was written off in the accounts for 2004-05.

It would be seen that in 11 cases, the Company had foregone Rs. 2.22 crore towards principal and FI and Rs. 0.63 crore due to restricting the settlement values to less than value of securities. Thus, the settlement formulae were neither consistent with RBI guidelines nor in the interests of the Company resulting in foregoing Rs. 2.85 crore.

Government stated (September 2008) that the sacrifice and OTS amounts were arrived at as per the settlement formulae of the schemes duly approved by the BoD. The fact, however, remains that the settlement formulae were neither consistent with RBI guidelines nor in the interests of the Company resulting in foregoing of Rs. 2.85 crore.

Absence of recovery measures on failure of OTS scheme

The Company neither ensured recovery of agreed OTS amounts, nor initiated recovery action under Section 29 and 31 of SFCs Act on failure of OTS cases.

2.3.17 OTS proposals of 10[Ψ] units were finalised between October 2004 and July 2006 at Rs. 6.02 crore against outstanding dues of Rs. 19.23 crore. Payments of the settled amount were to be received between October 2005 and July 2007. These units paid Rs. 1.64 crore partly, leaving balance of Rs. 4.38 crore. As a result, total outstanding dues against these OTS cases increased (May 2008) to Rs. 23.67 crore. As per the OTS terms, in case of failure, the amounts paid under OTS would be adjusted against the outstanding. Thus, the Company neither ensured for payment of agreed OTS amounts, nor initiated recovery action under Section 29 and 31 of SFCs Act on failure of OTS.

Government stated (September 2008) that the request of Ispat Chrome Limited and Ispat Minerals Limited for revalidation of OTS scheme was accepted (April 2008) by the BoD. In respect of Dynamic Studios (P) Limited action was being taken for recovery of its dues. The reply is silent about action to be taken against other seven failed OTS cases.

Poor response to OTS from NPA units

2.3.18 The BoD approved (April 2002) an OTS scheme for reducing NPAs. The Company gave publicity for the scheme by advertisement (May 2002) and sending (June/ July 2002) individual intimations to 174 eligible NPA units. OTS schemes in 2003 and 2007 were made available to the loanees through the Company's website. In spite of wide publicity and individual intimations, the Company finalised 34 cases of which 23 cases were completed during 2002-08. Absence of an enabling clause to bar the eligible NPA units from future OTS was the reason for poor and delayed response. Hence, the very objective of improving recoveries from NPAs through OTS was defeated.

Imprudent fixation of payment terms

2.3.19 As per RBI guidelines, OTS amounts should be paid in one lump sum. If borrowers are unable to pay in one lump sum, at least 25 *per cent* of OTS amount should be paid upfront and balance 75 *per cent* should be recovered in one year together with prevailing interest. The Company, however, relaxed the payment terms stating that OTS amount may be paid in one lump sum within 30 days or 25 *per cent* upfront in 30 days and balance 75 *per cent* to be paid in

[Ψ] 1. Dynamic Studios (P) Ltd; 2.Hotel Torrento (P) Ltd; 3.Ispat Chrome Ltd; 4.Ispat Minerals Ltd; 5. Laxman Chemicals & Pigments (P) Ltd; 6. Magnum Apparel (P) Ltd; 7. Premier Threads (P) Limited; 8. Rishabh Mining (P) Limited; 9. Suburban Hotels & Resorts Limited and 10. Sushila Cements (P) Limited.

six months without interest. In case of payment beyond six months applicable interest[∝] was payable.

Audit scrutiny revealed that in five[Σ] cases, OTS was finalised at Rs. 9.33 crore, of which Rs. 5.18 crore was realised with a delay up to 161 days i.e. beyond 30 days. Had the Company inserted a clause to claim interest for the balance amount paid beyond 30 days, it would have earned interest of Rs. 22.41 lakh.

Government stated (September 2008) that the Company was not coming under RBI guidelines and framed its own rules, which were approved by BoD. However, the rules framed by the Company did not safeguard the interests of the Company, as there was no clause to claim interest for delayed payments beyond 30 days.

Seizure and disposal

2.3.20 In order to expedite recovery of dues from defaulting units, Section 29 of SFCs Act provides for seizure and disposal of assets secured. Section 31 of the SFCs Act provides for filing of suits in the court of law for recovery of balance amounts, not realised through disposal.

The Company seized the assets of 118 defaulting units (including 13 units during 2003-08) so far during February 1983 to March 2008. The Company did not initiate seizure action against 25 defaulting units. The Company disposed of (March 2008) assets of 103[#] units (including 20 units disposed of during 2003-08). Of the remaining 24 (including nine units for which assets disposed of partly) seized units, 22 units are to be disposed of (March 2008) and two units settled their dues under OTS before disposal.

Audit analysed overall status of seizure, disposal and realisation of sale proceeds vis-à-vis outstanding dues. The details are given in the table below:

Details	Complete disposal				Part disposal		Awaiting disposal		
	No loss cases	Sharing pending with joint financiers	Sale deferred	Sharing completed with joint financiers	Dues realised	Dues not realised	Pending disposal	Recently seized	OTS settled units
Number of units	**8**	**15**	**2**	**69**	**3**	**6**	**11**	**2**	**2**
Period of seizure	Feb'83 to Aug'96	Aug'96 to Dec'06	July’06 to July’07	Sept'87 to Oct'07	Jan'02 to Apr'02	Mar'93 to Jan'02	Dec'86 to Nov'01		
Outstanding dues at the time of seizure (Rs. in crore)	2.26	21.11	3.87	86.21	8.93	5.02	46.25[$]	8.44[&]	5.82

[∝] Fourteen *per cent* during November 2003 to March 2007 and 13.5 *per cent* from September 2007 to March 2008.
[Σ] BDA Nicco Parks and Resorts Limited; Bimala Projects (P) Limited; Corrosion Protection (P) Limited; Puran Metal Industries (P) Limited and Shakti Sugars Limited.
[#] Assets of 94 units disposed of fully and 9 units partly.
[$] Dues outstanding as per Demand Summary for May 2008.
[&] Assets were seized recently in December 2007 and February 2008.

Details	**Complete disposal**				**Part disposal**		**Awaiting disposal**		
	No loss cases	**Sharing pending with joint financiers**	**Sale deferred**	**Sharing completed with joint financiers**	**Dues realised**	**Dues not realised**	**Pending disposal**	**Recently seized**	**OTS settled units**
Period of disposal	May'84 to Mar'97	Jul'2000 to Oct'07	Oct' to Dec'07	Sept'87 to Nov'07	Feb'03 to Nov'03	Jul'2000 to Mar'05			
Sale value (Rs. in crore)	5.12	4.05	1.54	52.60	1.93	1.27			
Company's share (Rs. in crore)	2.26	0.00*	0.00**	26.07	1.93	0.00*			1.92@
Total unrealised dues (Rs. in crore)	**Nil**	**21.11**	**3.87**	**60.14**	**7.00**	**5.02**	**46.25**		**No dues**

The Company failed to take timely action for seizure and disposal under Section 29 of SFCs Act which led to non-recovery of Rs. 143.39 crore.

It would be seen from the table that there was huge time gap between seizure and disposal and in the process the sale proceeds were belatedly realised. Taking into account total outstanding and amounts realised/adjusted, unrealised dues from 106 units were Rs. 143.39 crore due to insufficient securities, delay in disposal of seized assets and delay in finalisation of sharing of sale proceeds of disposed assets among joint financiers. Deficiencies in disposal of seized assets of four cases are as detailed in **Annexure 17**.

Government stated (September 2008) that the experience in disposal of seized assets was not encouraging due to various reasons like availability of few buyers/no buyers even after repeated advertisements, offer prices are much below the dues or promoters taking shelter under Court of Law as a result of which the seized assets remain unsold. However, non-disposal of seized units early forced the Company to spend huge amount on watch and ward of seized units. Had the Company taken timely action for seizure of the units when the asset value was higher than the outstanding dues, the problems narrated above could have been avoided.

Irregularities in action under Section 31 of SFCs Act

2.3.21 The Company is entitled to exercise legal action for recovery of balance dues under Section 31 of SFCs Act, where realisation of sale proceeds on disposal of the seized assets falls short of total dues.

Audit scrutiny revealed that:

- Out of 69 cases where there was shortfall of Rs. 60.14 crore, the Company filed suits in respect of 15 units for recovery of balance dues of Rs. 10.55 crore. Out of this, in two cases though decrees were awarded for realisation of Rs. 1.32 crore, execution petitions were not filed. In balance 13 cases though the assets were disposed of between December 1998 and November 2001, the Company filed suits (2003-06) for realisation of shortfall of Rs. 9.01 crore which were still pending (August 2008).

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* Sharing of sale proceeds is pending between OSFC and Company.
** Disposal finalised but sale is not effected due to litigation in High Court of Orissa.
@ Before disposal, units settled dues under OTS and loan accounts treated as closed.

The Company failed to file suits under Section 31 of SFCs Act for realisation of shortfall amount of Rs. 49.59 crore.

- The Company, however, did not take action to file the suits in respect of 54 units whose assets were disposed of during September 1987 to July 2006 and there was shortfall of Rs. 49.59 crore.

Government while accepting the delays stated (September 2008) that these were due to delay in sharing of sale proceeds and want of details of personal assets of guarantors. It was added that property details of promoters were not insisted upon in the earlier years and in few cases, promoters/guarantors expired.

Failure to realise other loans

2.3.22 The Company also disbursed STL, cyclone loans, soft loans, bridge loans and foreign currency loans. For the seized assets disposed, deferred loans were allowed as mentioned in paragraph 2.3.6. The status of recovery performance of the STL, cyclone loans and deferred loans during 2003-08 is shown in the table below:

(Amount: Rupees in crore)

Type of loan	Period of disbur-sement	No. of units	Amount disbu-rsed/ allowed	Outstanding principal as of March 2003	Outstanding as of May 2008	
					Principal	Interest
Short term loans	1976-2002	42	23.18	3.66 (19 units)	2.10 (13 units)	16.89
Cyclone loans	1999-2001	19	7.10	5.60 (18 units)	2.30 (10 units)	3.89
Deferred loans	1987-2003	46	11.52	9.18 (43 units)	5.20 (33 units)	17.45

Government stated (September 2008) that wherever possible, action had been initiated to recover the outstanding. The fact remains that out of dues from 37 parties as of March 2003 towards STL and cyclone loan, dues from 23 parties were outstanding (May 2008) indicating that the recovery action was inadequate.

- In respect of deferred loan, the Company recovered Rs. 2.11 crore (principal) only from eight units during 2003-08. In respect of two units the assets were reseized and disposed of for Rs. 0.59 crore with loss of Rs. 1.28 crore. The principal amount of Rs. 5.20 crore and interest of Rs. 17.45 crore remained unrealised from 33 units. This reflects absence of effective recovery measures against the defaulted units thereby defeating the very objective of disposal of secured assets and realising the dues out of sale proceeds.

Government stated (September 2008) that necessary action under Section 29 of SFCs Act was initiated in case of default by new buyers. It was added that the Company was selling the seized units outright without allowing deferment. However, out of 46 cases of deferred loans allowed upto March 2003, assets were re-seized and disposed of only in two[#] cases.

[#] East Land Impex (P) Limited and Maa Budhi Jagulai Polyethylene (P) Limited in 2006-07.

Monitoring mechanism

2.3.23 A well defined monitoring mechanism and Management Information System (MIS) reflect the existence of systems to make available timely, adequate and accurate information to the relevant authority in the organisation. The system of regular preparation of status report on various loanee units, periodical review of annual accounts of units, upkeep of registers for basic data of loanee units by Project Divisions, periodical physical inspections etc., is essential as a part of the best corporate practices. The following deficiencies in the monitoring mechanism were noticed:

- Summary report indicating the unit-wise outstanding dues and recovery position was not submitted to BoD for monitoring the outstanding dues at the highest level.

- The Project Divisions dealing with borrowing units were not maintaining registers containing borrowing unit-wise master data regarding total loan disbursed, dates of disbursements, value of industrial/collateral securities obtained, coverage of insurance and its renewal, personal/promoters' guarantees along with dates of expiry and renewal, property list of guarantors, dates of inspections of the units, dates of defaults, dates of recall notices issued, dates of seizure/disposal, filing of suits under Section 31 of SFCs Act etc. This indicates absence of effective monitoring of loans.

- As per the manual for entrepreneurs of the Company, the Project Divisions concerned were required to inspect the assisted units twice in a year to ascertain the safety and security of financed assets to know the unsecured component of loan as well to monitor and follow up the recovery position to avoid default. There was no evidence on record to confirm that the periodical (six monthly) inspection was conducted by the Project Divisions.

- Though the Company was holding Recovery Committee meetings periodically no such meetings were held after March 2006. Further, the proceedings of those meetings were never placed before the BoD.

There were deficiencies in the monitoring mechanism and Management Information System (MIS).

Government stated (September 2008) that nominee directors were appointed on the Board of borrowing units to review the status and to monitor the project. In the ARCPSE meeting, the Company accepted the audit findings.

Acknowledgement

Audit acknowledges the co-operation and assistance extended by the Management and staff of the Company at various stages of conducting the Performance Audit.

Conclusion

The Company was established to provide financial assistance to large and medium scale industries in the State. Sanction of loans was stopped from 2006-07. The Company did not have a system of exchanging information regarding defaulters of loans with other financing companies/banks and using the data on defaulting units available on the websites of Credit Information Bureau (India) Limited and RBI. The targets for recovery of loans were very low and ranged between 9.60 and 16.83 *per cent* of net demand; the Company failed to achieve even the low targets. Percentage of non-performing assets was very high (78.25 *per cent*) due to irregularities in sanction and disbursement of loans as well as absence of proper recovery measures. The OTS schemes followed by the Company were neither in line with the guidelines formulated by RBI, nor in the best interest of the Company, which contributed to loss of the Company. Action for recovery of dues under SFCs Act from defaulting units was not adopted.

Recommendations

- **The Company should fix realistic recovery targets well before commencement of the financial year aiming to maximise recovery of dues.**
- **Recovery measures should be strengthened by demand notices to all outstanding loanees along with regular follow up action.**
- **The Company should insist on valid/adequate collateral security of the assisted units.**
- **The Company should undertake periodical physical verification of the securities at the borrower's site at regular intervals so as to know the unsecured component and to take necessary steps.**
- **The Company should adhere to the time schedule for recovery as per the terms and conditions of the loan agreements and timely action for seizure and disposal under SFCs Act should be taken to avoid erosion in value of securities.**
- **Terms and conditions of OTS schemes devised by the Company should not only be consistent with the RBI guidelines, but also safeguard the interests of the Company.**

Orissa State Beverages Corporation Limited

2.4 Implementation of State Excise Policy and Trading in India Made Foreign Liquor, Beer and Country Spirit

Highlights

Lack of co-ordination between the Company and the Government as well as absence of policy for export of beverages resulted in loss of Rs. 2.83 crore towards Government revenue and the Company's margin.

(Paragraph 2.4.18)

Non-consideration of entry tax and non/delayed enhancement of offer prices resulted in short-realisation of Rs. 3.98 crore towards Government revenue and the Company's margin.

(Paragraph 2.4.15)

Application of inappropriate lower slabs for excise duty in the fixation of issue prices resulted in short-realisation of the Company's margin of Rs. 0.42 lakh and Government revenue of Rs. 3.50 crore.

(Paragraph 2.4.17)

Inappropriate determination of MRP resulted in undue favour of Rs. 36 crore to the retailers.

(Paragraph 2.4.20)

Due to anomalies in the pricing of Country Spirit, the Company, the retailers and the sales tax authorities were benefited by Rs. 10.47 crore, Rs. 6.29 crore and Rs. 1.99 crore respectively at the cost of the suppliers and the consumers.

(Paragraph 2.4.23)

Introduction

2.4.1 Orissa State Beverages Corporation Limited was incorporated (November 2000) as a wholly owned Government company with the main objectives to manufacture, purchase, import and export, carry on business as seller, dealer and distributor, act as stockist, commission agent, manufacturer's representative, selling and purchase agent, etc. of alcohol and other beverages. The legislative intent for creation of this Company was to bring wholesale distribution of foreign liquor and Country Spirit (CS) under Government control with a view to provide hygienic liquor and to check evasion of excise duty. In pursuance of this, the Company had an important role to play for implementing the State excise policies to the extent applicable to it.

The Company commenced its business from January 2001. The State Government conferred on the Company the exclusive right and privilege of importing, exporting and carrying on the wholesale trade and distribution of India Made Foreign Liquor (IMFL) and Beer in the State of Orissa by an amendment of the Bihar and Orissa Excise Act, 1915 with effect from 1 February 2001 and extended the right and privilege to CS from 1 May 2001.

The Company is carrying on the activity of wholesale trade and distribution of IMFL, Beer and CS within the State. The document, though, depicts the Company as the purchaser and seller of the stocks, it acts as a facilitator only without doing the purchase and sale in the strict sense of the term. None of the other activities envisaged in the objectives has been undertaken by the Company.

The Head Office of the Company is located at Bhubaneswar and there are six* depots for storing IMFL, Beer and CS. The Management of the Company is vested with a Board of Directors (BoD) consisting of six Directors including the Chairman and the Managing Director (MD). The MD is the Chief Executive of the Company who is assisted by the General Manager (Finance) and the Manager (Administration) at the Head Office and Branch Managers at depots. The sanctioned post of General Manager (Technical) which was to be filled up by an officer of the Orissa Excise Service is lying vacant since inception.

Scope of Audit

2.4.2 The present performance review conducted during November 2007 to March 2008, covers the performance of the Company in respect of wholesale trade of IMFL, Beer and CS and collection of duty and fees as per the State Excise policy during 2003-08. Audit test checked the records maintained at the Head Office and at the three depots (Balasore, Cuttack and Khurda), selected on the basis of turnover which worked out to 65 *per cent* of the total turnover.

Audit objectives

2.4.3 The Performance Audit was conducted with a view to assess whether:

- the targets fixed for the Company by the State Government for collection of Excise Duty/Import fee were achieved and revenue so collected was promptly deposited into the State treasury;
- procurement and storage of IMFL, Beer and Country Spirit was made economically and efficiently;
- the prices were fixed by the Price Fixation Committee (PFC) protecting the financial interest of the Company/Government;

* Balasore, Berhampur, Cuttack, Khurda, Rayagada and Sambalpur.

- distribution/sale/export of IMFL, Beer and Country Spirit was made efficiently and effectively; and
- cash discount was availed by the Company and investment of available funds was made prudently.

Audit criteria

2.4.4 The audit criteria adopted for assessing the achievement of the audit objectives were:

- revenue targets fixed by the State Government and provisions of the State Excise Policy;
- procurement and distribution/sale/export/investment policy of the Company/Government;
- instructions, decisions, etc. of the State Government and the BoD;
- proceedings and orders of the Price Fixation Committee; and
- agreement with manufacturers/suppliers and good commercial practice.

Audit methodology

2.4.5 The audit methodologies adopted for achieving the audit objectives with reference to audit criteria were:

- examination of Memorandum of Association and Articles of Association, year-wise excise policies of the Government of Orissa, minutes of the meeting of the BoD including agenda papers, sub-committee and those of review meetings held by Chairman/MD;
- scrutiny of procurement policy, pricing policy and records of the Price Fixation Committee, collection and remittance of Excise Duty and Sales Tax;
- extraction and analysis of data stored in the digital form through Interactive Data Extraction and Analysis (IDEA) software; and
- interaction with the Management and issue of audit queries.

Audit findings

The findings of the Performance Audit of the Company were reported (June 2008) to the Government/Management and discussed (5 August 2008) in the meeting of the Audit Review Committee on State Public Sector Enterprises (ARCPSE). The meeting was attended by the Commissioner-cum-Secretary, Department of Excise, Government of Orissa and the Managing Director of the Company. The views of the Government/Management have been taken into consideration while finalising the report. The audit findings are discussed in the succeeding paragraphs.

Excise revenue target and achievement

2.4.6 The suppliers of liquor are permitted to release the stock from their premises only after payment of excise duty (ED) and import fee[ø] (IF). As such, collection of ED and IF, which are the major components of excise revenue collected through the Company, depends upon the volume of supply made by the manufacturers as well as eventual sale to the retailers. The table below indicates excise revenue target fixed by the State Government for the Company and achievement thereagainst during 2003-08:

Year	Turnover	Target	Achievement[∞]	Shortfall	Percentage of shortfall
	Rupees in crore				
2003-04	378.01	185.46	140.38	45.08	24.31
2004-05	452.38	172.00	162.59	9.41	5.47
2005-06	522.80	317.00	207.73	109.27	34.47
2006-07	612.23	348.70	240.01	108.69	31.17
2007-08	744.59	325.68	301.89	23.79	7.30
Total	**2710.01**	**1348.84**	**1052.60**	**296.24**	**21.96**

The Company had neither fixed the targets of turnover for individual suppliers (except for 2006-07) nor monitored the target set.

Audit scrutiny revealed that the Company had not fixed the targets for individual suppliers except for the year 2006-07. Though it fixed (June 2006) supplier-wise turnover target for 2006-07 at Rs. 1,009 crore, the achievement was only Rs. 612 crore as neither the monthly targets were fixed nor periodical review was conducted. Further, the Company had not analysed the reasons to take remedial measures for achievement of the targets.

Government stated (August 2008) that the targets set by the Finance Department were without any scientific basis. However, the Company in none of these five years had made representation against higher/unscientific fixation of target.

Procurement performance

2.4.7 The manufacturers/suppliers desiring to sell their products in the State register their brands/ labels with the Excise Department of the State Government. Thereafter, they register themselves with the Company on payment of annual registration fee[£]. The Company enters into agreements with the registered manufacturers/suppliers for procurement of the registered brands of beverages. The Company sells these beverages to the licensed retailers on behalf of the manufacturers/suppliers.

[ø] In case of supply from outside the State.

[∞] It represents only the Excise Duty and Import Fee.

[£] Rs.15,000 since inception which was enhanced to Rs.20,000 from January 2004.

Exclusive right and privilege

The Company had no mechanism to ensure that the entire stock of beverages produced by the licensed manufacturers in the State was routed through it.

2.4.8 The Company has exclusive rights for wholesale trade in beverages in the State. It, however, does not have a mechanism to ensure that the entire stock of beverages produced by the licensed manufacturers is routed through it. The Company had neither collected the data on the actual quantity of beverages produced by the licensed manufacturers in the State nor attempted to cross-check with the information available with the Excise Department. During 2003-08, the Excise Department through enforcement activities seized 0.54 lakh litres of IMFL, 0.30 lakh litres of Beer and 0.15 lakh litres of CS valued at about Rs. 1.78 crore.

Government stated (August 2008) that the Company simply acts as an agency of the State Government within the parameters of law and policy determined by it and avoidance/evasion of excise revenue is controlled through its excise enforcement machinery. The fact remains that collection of data on production and distribution of beverages in the State and cross-checking with the information available with the Excise Department would strengthen the control exercised by the State Government.

Selection of manufacturers

2.4.9 For registration of suppliers, the Company invited applications only once in November 2000. Thereafter, the Company did not resort to open advertisement for empanelment of suppliers. Lack of open advertisement thus limited the scope of transacting in a wider range of brands in the State.

Government while accepting the audit observation stated (August 2008) to go for open advertisement every year for registration of more suppliers.

Agreement with manufacturers/suppliers

2.4.10 The Company enters into agreements with various manufacturers/ suppliers annually, which *inter alia*, envisage the offer price of the liquor.

Acceptance of offer prices lower than the agreed prices in fixation of price resulted in loss of revenue of Rs. 1.28 crore.

Audit scrutiny revealed that the copies of the agreements received by the Company were neither signed by any competent authority of the Company nor signed copies were returned to the suppliers for avoiding future legal disputes. The agreements were not made available to audit except for the years 2005-07. Review of the 66 agreements for 2005-07 revealed that in respect of 15 brands, the Company fixed issue prices by considering lower prices ranging from Rs. 5 to Rs. 39 per case[¥] than those offered by the suppliers. The reason for not considering the offer price was not on record. Application of lower offer price thus resulted in loss of revenue of Rs. 1.23 crore to the exchequer towards ED (Rs. 90.27 lakh), Sales Tax (Rs. 30.44 lakh) and tax collected at source (TCS) (Rs. 1.79 lakh) besides loss of margin of the Company for Rs. 5.44 lakh.

[¥] In case of IMFL, one case means 12 bottles of 750 ml or 24 bottles of 375 ml or 48 bottles of 180 ml or 96 bottles of 90 ml, in case of beer 12 bottles of 650 ml or 24 bottles of 330 ml or 24 canes of 500 ml and in case of Country Spirit, it is 50 pouches of 200 ml.

Government stated (August 2008) that since the cost of liquor in neighbouring states was cheap, the increase in the offer price was not considered as it would ultimately increase the consumer price resulting in encouragement of smuggling of liquor. However, the factors stated to have been considered in the fixation of issue price was not on record. The Company also did not have the data relating to cost of liquor in neighbouring states for comparing the cost offered by the suppliers.

Procurement of IMFL, Beer and CS

2.4.11 The table below indicates procurement of IMFL, Beer and CS during 2003-08.

(Quantity in lakh cases)

Year	IMFL			Beer			Country Spirit
	Within the State	Outside the State	Total	Within the State	Outside the State	Total	Within the State
2003-04	10.45	4.49	14.94	10.52	12.86	23.38	7.38
2004-05	15.68	1.98	17.66	16.86	13.55	30.41	7.60
2005-06	17.68	1.31	18.99	18.72	15.68	34.40	7.47
2006-07	19.87	1.85	21.72	20.19	11.45	31.64	8.91
2007-08	22.49	1.13	23.62	36.86	1.84	38.70	9.87
Total	**86.17**	**10.76**	**96.93**	**103.15**	**55.38**	**158.53**	**41.23**

The Company had not evaluated the brand preferences of the consumers for catering to the need of the consumers.

Audit scrutiny revealed that though there was increase in quantity of procurement, it was not indicative of timely catering to the demand and fulfilling the brand preference for the reason that the suppliers were supplying liquor of their own choice. The Company also had not done any demand survey to ensure adequate supply to satisfy the needs of consumers as well to curb the inflow of illicit liquor, besides increasing the revenue.

In the ARCPSE meeting Government accepted the absence of demand survey and assured to take care of this aspect.

Reconciliation of quantity procured

2.4.12 As per the prevalent arrangement, the Company on receipt of deposit towards ED and IF from the manufacturers, obtains transport, import, export (TIE) pass in its favour from the Excise Authorities after remitting the required ED and IF and hands over to the manufacturers. Similarly, the Company permits the suppliers for inter-depot transfer of stock through trade off passes obtained from the Excise Authorities. The Company, as the pass holder, not being involved in the physical release of materials and their transportation to the depots, is responsible to adopt a system to ensure that the entire quantity released from the factory/premises through TIE passes is duly received at the Company's depots. The Company, however, did not reconcile the quantity as per TIE passes with the Goods Received Notes at the godowns. This left room for leakage of the Company's margin and sales tax/value added tax (VAT).

Government stated (August 2008) that the actual receipt of stocks was duly checked up at the depot level with Goods Receipt Note (GRN). However, in the absence of reconciliation of GRNs with the TIE passes, GRN alone did not ensure the receipt of entire quantity released from the factory/depot.

Fixation of price

2.4.13 The suppliers declare the offer price on which entry tax[∝] (ET) and IF are added to arrive at the landing price. Thereafter, State ED and margin of the Company are added to the landing price to arrive at the issue price of IMFL and Beer. ST is imposed on the issue price. The Company remits ET, ED and ST to the State Government. Thus, the offer price is the basis for determination of state levies and the margin of the Company.

Price Fixation Committee

2.4.14 The State Government constituted (April 2003) a Price Fixation Committee (PFC) consisting of five members including MD of the Company as the member convener to determine the price of different brands of IMFL and Beer supplied through the Company with reference to their landing price in the neighbouring states. Audit observed that though the PFC started functioning from 1 April 2003, the prices of IMFL and Beer for the years 2003-04 and 2004-05 (upto June 2004) were fixed by the Company without getting the approval of PFC. The Company also did not put up compliance notes to the various decisions taken by the PFC during 2003-07.

Deficiencies in price fixation

2.4.15 IMFL and Beer are not essential commodities. As per agreement with the suppliers, it is the responsibility of the suppliers to market their products. The Company does not purchase the stocks from the suppliers in the strict sense of the term, rather it acts as an agent on behalf of the suppliers. The PFC also had no mechanism to evaluate the correctness of the price offered by the supplier that forms the basis for determination of issue price. It relied on the price offered by the suppliers. Against this backdrop, the PFC had little scope to control the price except determining it for the purpose of sales tax/value added tax (VAT).

Audit noticed deficiency in fixation of issue price by the PFC in the following cases:

- The PFC approved (October 2004) increase in offer prices of IMFL in respect of 62 brands of 17 suppliers by five *per cent* of the existing offer prices or as demanded by the suppliers whichever was less. The offer letters of the suppliers for revision of prices, which formed the basis for enhancements, were not made available to audit. In 37 items of nine suppliers, ET was not added to arrive at the issue price resulting in short realisation of Rs. 86.04 lakh towards ED, ST, TCS

[∝] Tax on the entry of goods into the local area of the State for consumption, use or sale therein.

and Company's margin during the years 2004-06. Further, for seven brands of Kaleast Bottling (P) Limited, the issue price was fixed taking the old offer price which was lower than the revised offer price resulting in short realisation of Rs. 8.35 lakh towards ST, TCS and Company's margin during 2005-06.

Government while accepting the audit observation stated (August 2008) that ET would be included to arrive at the revised landing cost.

- Agreements with the suppliers provide for enhancement of offer prices due to increase in statutory dues. In the excise policy for 2005-06 bottling fees and franchise fees for IMFL and Beer were enhanced. In respect of five suppliers the PFC enhanced the prices by an amount equal to the actual increase in state levies only with effect from June 2005 though they had applied for enhancement in April 2005. Delayed enhancement resulted in loss of revenue of Rs. 18.95 lakh on sale of 2.09 lakh cases of IMFL. Further, it did not allow any enhancement to SKOL Breweries on the ground that the decision on allowing franchise fees and bottling fees was pending with the Government. Non-enhancement of price on account of increase in bottling fees, which was not under dispute, resulted in loss of revenue of Rs. 1.13 crore on sale of 17.58 lakh cases of Beer during 2005-06.

Non-consideration of the entry tax for fixation of price and delay/non-enhancement of offer price resulted in loss of revenue of Rs. 3.98 crore.

- Though six suppliers had applied for increase in their offer prices, the PFC, for reasons not on record, decided (October 2004) that the existing prices of Beer would continue for the time being. It allowed the enhancement upto a maximum of five *per cent* of the offer price only from June 2005 in respect of five suppliers and by Rs. 13 per case in case of SKOL Breweries. The delayed enhancement by eight months resulted in loss of revenue of Rs. 98.80 lakh towards the Company's margin (Rs. 21.84 lakh) and Government revenue towards ET (Rs. 3.06 lakh), ST (Rs. 69.41 lakh) and TCS (Rs. 4.49 lakh) during October 2004 to June 2005.

- Shaw Wallace Breweries Limited requested (April 2003) the Company for upward revision of the offer prices of two brands of Beer with effect from 1 April 2003. The Company, however, did not increase the prices for reasons not on record and continued to issue these two brands to the retailers at the un-revised price during 2003-05. This resulted in short realisation of revenue of Rs. 73.48 lakh on sale of 21.89 lakh cases towards margin of the Company (Rs. 15.74 lakh), ST (Rs. 51.48 lakh) and TCS (Rs. 6.26 lakh).

Government stated (August 2008) that ramifications of consumer interest, smuggling, etc. were considered by PFC in deciding the price. However, the PFC belatedly approved the enhanced prices for reasons not on record. Moreover, the agreements with the suppliers provide for the price to remain valid at the option of the suppliers.

Switchover of source of supply of IMFL

2.4.16 The PFC decided (October 2004) that the differential transportation cost should be deducted from the offer price of four[β] suppliers who switched over the source of supply from outside to inside the State during 2003-05. The PFC only after seeking opinion of the Excise Commissioner approved (March 2005) for deduction of differential cost of transportation ranging from Rs. 11 to Rs. 17.47 per case from the date of their switchover since the suppliers had not reduced their offer prices in spite of reduction in the cost of transportation. The Company, however, did not implement the decision of the PFC, which amounted to extension of undue favour of Rs. 40.40 lakh to these suppliers.

Government accepted (August 2008) the observations of audit for recovery of the differential amount.

Application of inappropriate slab for excise duty

2.4.17 The annual excise policies for the years 2003-08 provided for assessment of ED on the landing cost of IMFL. The landing price was divided into three to four slabs and the higher slab of landing price attracted the higher ED. The Company defined landing price as the offer price including ET and IF (if any). As per Part-I of the Schedule to the Orissa Entry Tax Act, 1999, ET for IMFL/Beer would be levied at the rate of one *per cent* on the purchase value inclusive of ED. Thus, determination of ET depended upon determination of ED.

The Company, while computing the ET and ED, considered the offer price as landing price and adopted the corresponding ED slab and calculated the ET. The total of ET so calculated and offer price was treated as the dummy landing price on which ED was calculated. Thus, the final dummy landing cost decided the slab of ED. In this process the Company allowed the suppliers to have the benefit of lower ED slab in respect of border line cases. The Company should have considered both the bordering slabs of ED (higher and lower) to arrive at the ET for final settlement of the landing price for determination of the appropriate slab of ED.

Computation of excise duty on the inappropriate lower slabs resulted in loss of revenue of Rs. 3.92 crore.

Test check of records revealed that inappropriate lower slabs for ED was considered in respect of 28 brands of IMFL in the fixation of their issue prices resulting in short-realisation of the Company's margin of Rs. 0.42 lakh and Government revenue of Rs. 3.50 crore towards ED (Rs. 2.86 crore), ST (Rs. 60.10 lakh) and TCS (Rs. 3.53 lakh) during the years 2005-08.

Government stated (August 2008) that higher bordering slabs of ED as per audit observations would be taken care of.

[β] Jagatjit Industries Division-I, Jagatjit Industries Division-II, Radico Khaitan and TDV Limited.

Export management

Absence of terms and conditions for export coupled with delay in according permission for export resulted in loss of revenue of Rs. 2.83 crore.

2.4.18 The Company allowed (March 2001) the manufacturers to export liquor at their own risk by collecting service charges at the rate of one *per cent* of the invoice value. Though, the excise polices during 2001-06 provided for collection of export fees, neither the State Government nor the Company formulated any policy/detailed procedure for export of beverages upto March 2006. Thus, there was no system to ensure that the excise levies and other applicable fees were realised and stock meant for the export actually reached the destination without being misused enroute. After announcement of export policy in March 2006 and approval of detailed procedure for export of IMFL and Beer in October 2006 by the State Government, 2.77 lakh cases of Beer were exported through the Company during November 2006 to March 2008.

Audit observed that Maikal Breweries (Private) Limited (MBPL) applied (July 2006) for export of 10-12 lakh cases of Beer after fulfilling the demand of the State. The Government, however, permitted to export only in March 2007 as a result of which 10 lakh cases of Beer could not be exported. Hence, the Company lost revenue of Rs. 18.90 lakh towards export service charges besides loss to the State Government of Rs. 2.64 crore towards export fee, franchise fee, etc.

As regards delay in according permission to MBPL, the Management stated (July 2008) that permission to export was granted (March 2007) only after submission of wanting documents as per the approved guidelines. The fact of non-submission of required documents by the supplier was, however, not on record.

Display of maximum retail price (MRP)

2.4.19 Following an amendment in the Standards of Weights and Measures (Package Commodities) Rules, 1977, during 2003-04, MRP was to be displayed on the bottles containing alcoholic and spirituous liquor.

Audit observed that the Company displayed MRP from April 2007 after a delay of four years which not only led to violation of statutory provisions but also provided scope to the retailers to charge higher prices. The violations had also entangled (January 2006) the Company/State Government in public interest litigation which was pending in the High Court of Orissa (August 2008). Despite this the Company had not displayed MRP on CS from 1 April 2007 and on the unsold stock of bottles of IMFL and Beer as on 31 March 2007.

Government stated (August 2008) that as per the Packaged Commodities Regulations Order, 1975, it was not necessary to declare price on package of alcoholic beverages and during 2006-07, the Government of India, Ministry of Food Processing amended the said regulations requiring declaration of price on alcoholic beverages, which was implemented by the Company from April 2007. Thus, there was no violation of statutory provisions. The reply is contrary to the fact that the exemption for display of MRP on bottles containing alcoholic beverages was withdrawn from 2003-04, for which there was non-compliance of statutory provisions.

Determination of MRP

2.4.20 For determination of MRP for various brands, the Maximum Retail Price Committee (MRPC) adopted (September 2005) a formula based on a specimen price of 180 ml bottle of IMFL under three different ranges of landing cost viz. below Rs. 600 (cheap), Rs. 600 to Rs. 850 (medium) and above Rs. 850 (premium) per case. After adding the applicable ED, Company's margin, VAT, TCS, etc., the cost per bottle to the retailer was determined. After allowing licence fee of Rs. 5 per bottle, fixed/variable cost at Rs. 3.10 per bottle and a profit margin of 10 *per cent* of the total cost, the MRP was fixed. The overall margin to the retailer on the cost per bottle worked out to 41, 34 and 25 *per cent* of the three price ranges respectively. Similarly, for Beer and scotch, the overall margin to the retailers worked out to 32 and 12 *per cent* respectively. Based on this formula, the Company fixed the MRP adopting the overall margin of 41, 34, 25, 32 and 12 *per cent* on the cost per bottle to the retailer instead of considering the individual components of cost and profit.

Audit observed the following deficiencies in determination of MRP:

Adoption of wrong basis for determination of maximum retail price the retailers were unduly benefited by Rs. 36 crore.

- The MRPC worked out (February 2006) licence fee of Rs. 5 per bottle considering a uniform minimum guaranteed quantity (MGQ) of 22 London Proof Litre (LPL) of IMFL and 33 Bulk Litre (BL) of Beer for licence fee of Rs. 1,000. As per the State Excise Policies for 2006-07 and 2007-08, for licence fee of Rs. 1,000, MGQ was fixed at 26 LPL of IMFL and 40 BL of Beer for urban areas and 23 LPL of IMFL and 35 BL of Beer for rural areas. As such, the maximum licence fee per bottle of 180 ml was Rs. 4.46. Thus, adoption of wrong basis for determination of licence fee per bottle resulted in higher recoupment of licence fee by Re. 0.54 per bottle and MRP was also fixed accordingly. On the sale made in 2007-08, the retailers were unduly benefited by Rs. 8.41 crore towards recoupment of licence fee due to higher MRP.

- Adopting the formula of a flat overall margin on landed cost per bottle on percentage basis the Company allowed the retailers a higher profit margin than the intended margin of 10 *per cent* on cost (i.e. retailers cost per bottle plus licence fee, fixed and variable cost). The excess MRP per bottle of IMFL and Beer of various sizes varied from Re. 0.08 to Rs. 62.91. The higher margin allowed to the retailers due to higher MRP amounted to Rs. 27.59 crore on the sales effected through the Company for 2007-08.

Government stated (August 2008) that the licence fee during 2007-08 was hiked by 10 *per cent*. On the basis of the MGQ the retailers were reimbursed Rs. 1,028 as against payment of Rs. 1100. It was added that the MRP formula was a guideline and in any formula there would be some leeway which cannot be totally curbed. Audit observed that the MRPC considered uniform MGQ per Rs. 1000 of licence fee as the basis for recoupment of licence fee. Any hike in the licence fee shall, therefore, have no impact on the cost of licence fee per bottle as the MGQ shall be proportionately fixed on the higher side. Further, adoption of overall margin on percentage basis deviated from the principle of reimbursement of fixed/variable cost and intended percentage of profit.

Apportionment of sales realisation

2.4.21 On issue of the stock of IMFL, Beer and CS to the retailers, the Company makes apportionment of the sale proceeds realised towards ST, TCS, landing price, ED, ET (in case of supply from outside the State) and its margin. It passes the landing cost including IF and ED to the suppliers as these are paid in advance and after accounting for taxes, retains the balance as its margin. The revision in the rate of ED and IF by the Government, therefore, calls for computation of differential ED on the unsold stock and its payment to the Government.

Audit observed the following:

- The Company did not realise the differential ED and IF from the suppliers on the unsold stock at the beginning of the date of revision of rates. Even after realisation of the differential amount at the time of sale, there were delays ranging from 6 to 16 months on the part of the Company to deposit the realised differential ED amounting to Rs. 9.25 crore with the Government during 2003-07.

- In the Excise Policy for 2006-07, the ED on CS was enhanced by Rupees six per case. The supplier had included the enhanced ED in the offer price and deposited it at the time of supply. But while making apportionment of the sale proceeds of CS from April to December 2006, the enhanced ED amounting to Rs. 37.85 lakh was not credited to the supplier’s account and was booked under the Company’s margin.

Government stated (August 2008) that the complete computerisation of accounts was in progress for which there was delay in realisation and deposit of differential amount. Regarding non-crediting to supplier's accounts, the audit observation had been noted for future guidance.

Country Spirit

2.4.22 The consumers of CS are generally from economically weaker sections of the society. Consumption of CS from unauthorised sources could lead to serious health hazards including loss of life as well as loss of Government revenue. As per the Excise Policy 2001-02, supply of CS by the Company was permitted in 16 out of 30 districts in the State. Subsequently (2003-04), it was restricted to 13 districts and further (2006-07) restricted to 10 districts to give way to out-still liquor.

Procurement, distribution and fixation of price

2.4.23 The Company procured CS only from Aska Co-operative Sugar Industries Limited (ACSI) since May 2001. The percentage of sales to procurement was ranging between 98.27 and 101.46 during 2003-08 indicating a high demand for CS each year.

Audit observed the following:

- The Company had never evaluated the demand for CS and adequacy of its supply. The Branch Manager, Khurda informed (December 2007) the MD that though the supply of CS was more than the MGQ (20,952 cases per month), the actual demand was 36,000 cases. Though there was shortfall in meeting the demand for CS, the Company did not tap other sources[µ] for its procurement for maintaining steady supply so as to minimise the risk of consumption of unhygienic illicitly distilled CS.

- The State Government fixed (November 2001) the retail price of CS pouch of 200 ml at Rupees nine inclusive of all taxes and duties based on the corresponding landing price of Rs. 3.50 and margin at 7.5 *per cent* of the landing price. An analysis of the cost sheet revealed that proper sequence of the cost elements to arrive at the retail price had not been followed. This was because the Company's margin, which was to be computed on landing price excluding ED and ST as followed by the Company in case of IMFL and Beer, had been computed on total of landing price, ED and ST. After detection (November 2001) of the deficiency in pricing, although the Company recalculated the retail price at Rs. 8.75 per pouch it absorbed the excess amount towards increase in its margin from 7.5 *per cent* to 13.22 *per cent*, increase in ST and retailers' margin. Similar anomalies in fixation of price continued on five[¥] occasions for revision of supply prices during August 2004 to August 2006.

- The State Government increased (September 2005) the cost of supply from Rs. 4.30 to Rs. 4.45 per 200 ml pouch. The Company, however, did not pay the revised amount to ACSI till 31 March 2007, which resulted in retention of Rs. 87.82 lakh by the Company.

- The State Government fixed (September 2006) the retail price at Rs. 13 per bottle of 200 ml considering packing of CS in glass bottles instead of poly pouches. ACSI, however, supplied CS in poly pouches due to its inability to supply in glass bottles. In spite of this, the MRP of Rs. 13 was not changed, as a result of which the retailers got unduly higher margin of Rs. 6.29 crore.

Thus, due to the above deficiencies in pricing, the Company, retailers and ST authorities were benefited by Rs. 10.47 crore, Rs. 6.29 crore and

[µ] Sakti Sugars Ltd., Ganjam Jeypore Sugar Co. Ltd and Koraput Umeri Distillery, Koraput.
[¥] August 2004, October 2004, April 2005, September 2005 and August 2006.

Due to deficiencies in pricing the Company, the retailers and ST authorities were benefited by Rs. 10.47 crore, Rs. 6.29 crore and Rs. 1.99 crore respectively.

Rs. 1.99 crore at the cost of the suppliers and consumers by Rs. 87.82 lakh and Rs. 17.87 crore respectively.

Government stated (August 2008) that there were no manufacturers of CS in the State other than ACSI. The fact remains that there were four other sugar factories in the State which could have been tapped for manufacture of CS. As regards retention of excess margin the point was noted for rectification. It was added that fixation of retail price of CS in glass bottles was as per negotiation with the supplier. But in view of supply of CS in polypouch, the MRP should have been reduced.

Margin on operation and recovery of expenses

2.4.24 The BoD decided (December 2000) to charge the Company's margin on operation on IMFL and Beer at a rate ranging from 6 to 12 *per cent* of the landing cost on a graded scale in addition to the fixed and direct expenses. It, however, did not specify the fixed and direct expenses. The agreements with suppliers also remained silent regarding recovery of fixed and direct expenses. The margin was increased (March 2004) by two *per cent* on each slab and again by one *per cent* in June 2006.

Audit observed the following:

The Company did not recover insurance and godown rent amounting to Rs. 3.84 crore from the suppliers/ manufacturers.

- There was no scientific basis for determining the rate of margin. Even the cost of operation and the normal rate of profit were not taken into account while fixing the margin.

- The Company though recovered insurance charges of Rs. 6.02 lakh from the suppliers for the year 2006-07, the insurance charges of Rs. 25.78 lakh for 2003-06 and godown rent of Rs. 3.58 crore for 2003-08 were not recovered though these were direct/fixed expenses.

- The BoD approved the enhancement of the Company's margin by one *per cent* on 28 June 2006. The Company, however, implemented it with effect from 28 July 2006. The delayed implementation of the approved enhancement resulted in loss of revenue of Rs. 23.66 lakh towards the Company's margin (Rs. 19.50 lakh) and Government revenue towards VAT (Rs. 3.90 lakh) and TCS (Rs. 0.26 lakh).

Government stated (August 2008) that there was no decision of BoD for recovery of insurance charges during earlier periods. It was added that there was no necessity for recovering godown rent from the suppliers as the ownership rested with the Company. The fact, however, remains that the principle for fixation of margin and recovery of fixed and direct expenses from suppliers was not clearly defined. The contention of the Management (July 2008) that due to observance of formalities, there was delay in implementation of the approved enhancement of the Company's margin is not tenable as this required only recalculation of the issue price with a mere change of formulae in the system.

Cash discount and investment of surplus fund

2.4.25 As per agreement, the suppliers were to be paid the sale proceeds after a period of 45 days from the date of receipt of consignment. For payments made before the 45th day, the Company was to deduct cash discounts at the rates of 1.5, 1 and 0.5 *per cent* for payments made within 1 to 15, 16 to 30 and 31 to 45 days respectively. Considering this process of calculation as complex the Company adopted varied rate of cash discount ranging from 0.5 to 1 *per cent* taking one month as a block period. The Company engaged a software consultant in January 2004 to develop a package for calculating cash discount as per the agreement. As per the computation made by the agency, the cash discount realisable up to the year 2003-04 worked out to Rs. 2.57 crore. On this basis the Company realised (February 2005) the differential amount of Rs. 1.54 crore from the suppliers. The software developed by the agency was not retained by the Company. In the absence of software and supporting papers the correctness of the calculation made for realisation of cash discount could not be verified in audit. For want of the software, the Company computed the cash discount on provisional basis for the subsequent years thereby taking the risk of short/excess charging of cash discount, besides incorrect depiction of the financial position of the Company in the Balance Sheet.

Further, as the Company does not immediately pass on the suppliers their share of the sale proceeds and deposits sales tax/VAT in the succeeding month of collection, surplus cash balances accrue during the intervening period. This surplus cash is also supplemented by the Company's margin which generates profit regularly. During the period 2003-08, the Company, though parked its surplus funds in short term deposits, had minimum balance of fund ranging between Rs. 8.52 lakh and Rs. 14.74 crore in its current accounts. In spite of such huge balances in the current account, the Company did not avail of the benefits of the current flexi account scheme for which it lost an opportunity of earning interest income of Rs. 1.04 crore.

Parking of fund in current account instead of flexi account resulted in loss of Rs. 1.04 crore.

Government stated (August 2008) that in order to ensure utmost credibility in computing cash discount, development of software was in progress. As regards availing of flexi deposit scheme, the observation of audit was noted for compliance.

Liability towards Service Tax

2.4.26 The Company received (January 2002) a notice from the Central Excise and Customs (CEC) Authorities for registering under section 69 of the Finance Act, 1994 for levy of Service Tax on the service provided by it as a clearing and forwarding agent. The Company replied (February 2002) that registration under Service Tax was not necessary as it was doing "wholesale trading." The CEC authorities then held (March 2007) the Company liable for payment of Service Tax on its gross volume of taxable services from 2002-07 and requested the Company to pay the Service Tax dues before 31 March 2007. The Company got itself registered (March 2007) and paid Rs. 3.68 crore under protest. The BoD decided (June 2007) to collect the

Service Tax paid by the Company from the suppliers as per the terms of the agreement. The CEC authorities intimated (December 2007) the Company that it was liable to pay Rs. 11 crore towards Service Tax from 16 August 2002 to December 2007. In the meantime, the Company decided (February 2008) to pay Rs. 5.62 crore under protest and claimed the amount from the suppliers. The suppliers however protested the recovery and one of them filed (January 2008) a suit in the High Court of Orissa against the decision of the Company which was pending for decision (August 2008).

Audit observed that on receipt of the notice of CEC authorities, the Company should have assessed its implication and decided whether to bear the liability or to pass it on to the suppliers by amending the agreement clause as the existing clause to enforce recovery of Service Tax was not clear.

Government stated (August 2008) that owing to mounting pressure of CEC authorities the Company got itself registered under Service Tax Act under protest and as per the terms of the agreement the Company was passing on the liability to the suppliers retrospectively. It was added that since the final assessment was not received from the CEC, the Company had not moved to a higher forum. The Company, however, should have decided on the matter of payment of Service Tax as well as collection from suppliers immediately after the receipt (January 2002) of notice of CEC authorities.

Internal control

2.4.27 Internal control is a management tool which helps the Management to draw reasonable assurance that its objectives are being achieved in an efficient and effective manner. The following deficiencies were noticed in the internal control system being followed by the Company.

- The Company did not fix any norm for shortage/breakage in transit and storage to prevent the possibility of pilferage in transit and in the godowns.

- There was no system on record to ensure that the stock received at its godowns was duly affixed with the excise adhesive labels (EAL) as per the excise policies to prove the genuineness of the products besides collection of EAL fees.

- There were instances of use of money receipts and gate passes on plain paper instead of using printed books as supplied by the corporate office. The Company did not exercise any control over the utilisation of money receipt books, goods received notes and gate passes. In absence of such control, chances of fraud cannot be ruled out.

- The Company had no Accounts Manual to streamline the accounts keeping process.

- As the batch wise entry of inward stocks with a code for identification was not recorded, the actual outward movement of stocks received first could not be ensured in audit.

- Bin card system has not been implemented in the depots. Re-ordering level is also not maintained by the Company.

Government stated (August 2008) that due to space constraint, dearth of manpower etc., the recording of batch wise entry of inward stocks was not practically feasible. Other points raised in audit were noted for compliance.

Internal audit

2.4.28 The Company did not have its own Internal Audit Wing. The internal audit of the corporate office was entrusted to a firm of Chartered Accountants. The Internal Auditor submits its reports to the MD and the Chairman. The reports of the internal auditor alongwith compliance reports were not placed before the BoD or the Audit Committee constituted (June 2006) by the BoD.

Government stated (August 2008) that by submitting the reports to Managing Director/Chairman, the objective of internal audit was achieved. The fact is that the compliance reports were neither prepared nor put up to the BoD and the Audit Committee.

Manpower

2.4.29 The State Government sanctioned (December 2000) 71 posts of different categories of employees including 12 posts of executives (excluding MD) to be filled in by deputation from other departments/ state PSUs for smooth functioning of the Company which was reduced (July 2002) to 63 including 13 executives. The men in position of regular employees ranged from only 25 to 33 during 2003-08.

Audit scrutiny revealed the following:

- Even after eight years of its incorporation, the Company did not have its own cadre of employees. The Company, however, deployed 111 to 191 employees during 2003-08 through service providers in the cadres of depot assistant, depot attendant, computer operator and security staff for execution of its day-to-day work. Thus, the total men in position of the Company ranged from 142 to 223 which was in excess of the sanctioned posts.

- Frequent changes in staff in the Accounts branch led to delay in finalisation of annual accounts.

- The Company had not fixed any norm for deployment of manpower in its different depots.

Government stated (August 2008) that the Company would take up the matter at Government level for permanent absorption of deputed staff and action had been initiated for filling up of vacant post of branch managers as well as fixation of norms for deployment of manpower in depots.

Software development

2.4.30 The Government decided (May 2004) to develop a Management Information System (MIS) package for the Excise Department and the Company. The Company issued (July 2006) the work order to Formula One Solutions Private Limited at a price of Rs. 13.72 lakh. The agreement was, however, signed in March 2007. Thus, there was inordinate delay in finalising and awarding the contract. The work, scheduled to be completed by September 2007, was, however, not completed (August 2008). Due to non-completion of the project, the intended benefits of MIS towards formulation of new policies for better management and distribution of liquor and improved accounting applications could not be achieved.

Government stated (August 2008) that delay in development of MIS package was caused due to delay in awarding the contract.

System inadequacies

2.4.31 The Company maintains inventory, sales and purchase details in SQL database and accounts in Tally software. This system suffered from various system design deficiencies, input and validation controls as discussed in the succeeding paragraphs.

Input control and validation checks

2.4.32 Proper input control and validation check ensures that the data entered are authorised, complete and correct. Audit scrutiny revealed the following deficiencies:

- The sales invoice could be prepared before receipt of the sale proceeds, though the Company follows the prepaid system.
- Money receipt dates were prior to the date of receipt of drafts.
- The system allowed raising of sales invoice in the names of persons other than the actual payer.
- The transit pass was issued before the issue of invoice.
- The supplier cannot send goods before the excise permits are obtained. The goods were, however, received before the date of excise permit.

Government while noting (August 2008) the observations of audit for future guidance stated that the deficiencies were being taken care of in the new software under development.

System design deficiencies

2.4.33 The system design deficiencies are discussed below:

- The sales invoice date was not auto generated giving scope for entry of wrong data leading to wrong generation of sales report, etc.

- The system did not provide for any audit trail/log for the entries made.

- The system did not provide for reconciliation of stock account resulting in difference in quantity of stocks transferred and received in case of inter-depot transfers.

- The closing stock of the previous year was not tallying with the opening stock of the following year during 2003-07; the differences ranged from 863 to 46,110 cases of beverages.

Government while noting (August 2008) the observations of audit for future guidance stated that the deficiencies were being taken care of in the new software under development.

Acknowledgement

Audit acknowledges the co-operation and assistance extended by the Management and staff of the Company at various stages of conducting the Performance Audit.

Conclusion

The Company being the exclusive right holder for wholesale distribution of beverages neither made a study to ascertain the position of supply/demand of IMFL, Beer and Country Spirit nor compiled the data on production and demand to enable a smooth and regulated distribution of liquor. In the absence of demand survey, the Company could not achieve the revenue target set for it in any of the years as it did not fix and review the supplier-wise target. There were anomalies in application of appropriate rate of excise duty and pricing causing loss to the Company as well as to State Government. The Company also did not take steps to export beverages to earn more revenue. There was delay as well as inappropriate determination of Maximum Retail Price resulting in undue favour to the retailers. The fund management, data management and internal control system of the Company were inadequate.

Recommendations

The Company may consider:

- **making a demand study and compiling the data on production so as to be in a position to ensure a smooth and regulated distribution of liquor with optimisation of Government revenue;**

- **taking timely and adequate steps to implement various related activities as spelt out in the excise policy;**
- **arranging for appropriate fixation of price of beverages in time through Price Fixation Committee and implement the same to avoid loss of revenue;**
- **improving its data management and accounting system; and**
- **strengthening its internal control system.**

Orissa Power Generation Corporation Limited

2.5 Implementation of Enterprise Resource Planning System

Highlights

The Company implemented the Enterprise Resources Planning System only in three areas viz. Purchase, Inventory and Maintenance.

(Paragraph 2.5.1)

The Company had no formal IT Policy.

(Paragraph 2.5.5)

The system had not been designed properly resulting in generation of conflicting data.

(Paragraphs 2.5.6 and 2.5.7)

Inadequate input and validation controls resulted in lack of data integrity and incorrect MIS.

(Paragraphs 2.5.9 to 2.5.15)

The Company did not explore the utilisation of the facilities though available in the system.

(Paragraph 2.5.19)

Introduction

2.5.1 Orissa Power Generation Corporation Limited was incorporated in November 1984 as a wholly owned Government company with the main objectives of establishing, operating and maintaining thermal power generating stations in Orissa. The Company installed (October 1995) a 2 X 210 MW Thermal Power Station at Ib Valley, Banharpali, Jharsuguda.

For an effective asset management strategy, the Company implemented (October 2002) Ramco e-Application, an Enterprise Asset Management System. Initially, the Company implemented only three modules (Maintenance Operation, Purchase and Inventory).

Accordingly, the Company entered into a turnkey contract (February 2000) with Computer Maintenance Corporation Limited (CMCL), a Government of India undertaking, for supply and installation of necessary hardware and software at a total cost of Rs. 1.10 crore (Hardware Rs. 85.50 lakh and Software Rs. 24.50 lakh). The Company implemented Ramco e-Application Software Systems (October 2002) in a Client Server Environment with

Compaq Proliant 3000 Intel P3 Server and Windows NT as the Operating System. SQL Server 7.0 package is used as the backend database software. Out of the total 18 licences of Ramco e-Application supplied by CMCL, the Company is presently using 13 licences among the 16 user departments on 98 nodes. The overall control of the system rests with a Manager (IT).

Scope of audit

2.5.2 The audit of the three implemented modules of Ramco e-Application viz. Purchase Module (PM), Inventory Module (IM) and Maintenance Operations Module (MOM) was conducted for the period from 2004-05 to January 2008 during January to March 2008.

Audit objectives

2.5.3 The audit was conducted with a view to assess whether:

- the business rules were correctly mapped and the system was customised in conformity with these;
- the implementation of different modules had achieved the desired results; and
- adequate controls existed to ensure complete and reliable data in the system.

Audit methodology

2.5.4 The audit analysed the Microsoft Excel Reports generated through queries from the database on 9 January 2008 using computer assisted audit techniques (CAATs). The information as furnished by the Management to the questionnaires issued was also utilised.

Audit findings

It was observed in audit that the system had deficiencies with respect to system design, codification, input/validation controls etc. which resulted in ineffective and inefficient management of the system. The audit findings are discussed in the succeeding paragraphs.

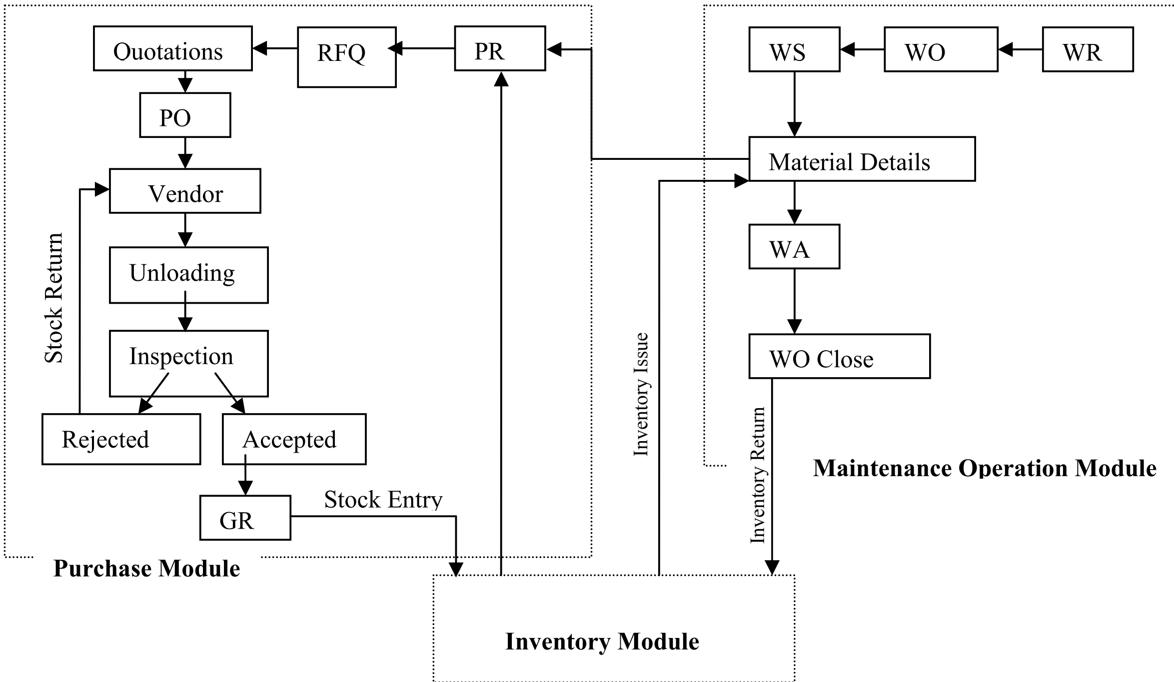
Planning and implementation

2.5.5 The Company did not have an Information Technology (IT) policy and any Information System (IS) security policy either. The Company is yet to begin the business reengineering to frame the business blue print. Further, change management policies and business continuity plan were yet to be defined.

The test reports regarding performance guarantee test conducted by CMCL in October 2002 after implementation of the system were not made available.

System design

2.5.6 The three modules are integrated with each other as shown below:



Note: PR-Purchase Request, RFQ-Request for Quotation, PO-Purchase Order, GR-Goods Received, WR-Work Request, WO-Work Order, WS-Work Scheduling, WA-Work Actual

Materials issued from the stores are accounted in the Inventory Module against the work order generated based on the work requests from plants. Based on the availability of the material, purchase requests and purchase orders are generated in the system. Goods received are inspected and accounted as stock. After completion of works the consumption of materials is accounted through MOM in the system.

Design deficiencies

2.5.7 The issues against work orders were accounted in the system under three different categories i.e. *'inventory', 'maintenance' and 'unplanned'* whereas returns were accounted under two categories only i.e. *'inventory'* and *'maintenance'*. Due to the deficiency in the system design, the items issued under *unplanned* category were not treated as consumed and returns under *inventory* category were still treated as consumed. This resulted in mismatch between the issue and consumption details generated through the system.

Data analysis revealed that in 257 cases (115 in 2004-05, 57 in 2005-06, 58 in 2006-07 and 27 in 2007-08) the issues after accounting the returns did not match with the consumption details.

The Management accepted the observation (May 2008) and stated that users accounted *unplanned* issues against closed work orders which should have been done by making sub-work orders. It further stated that users were instructed to return the material before closing the work orders so that actual consumptions could be reflected in the system. The reply substantiates the existence of deficiencies in the system as it could permit further transactions on closed work orders as discussed in paragraph 2.5.15.

Logical access controls

2.5.8 The Company implemented Ramco e-Application with 18 concurrent user licenses. Each department was assigned with a user name and password which was being shared by all the authorised users in a particular department. It was observed that access rights could not be defined to a particular user due to limited user licenses resulting in absence of accountability.

Further, it was observed that the audit trail facility though available was also not utilised and as such no record of the transactions performed like adding, modifying and deleting data during a transaction was available.

Input control and validation checks

Input controls and validation checks ensure that the data entered into the system are complete, authorised, correct and valid. Analysis revealed the following:

Fixation of inventory levels

2.5.9 System provided for effective management through fixation of maximum, minimum and reordering levels. The Company, however, has not fixed any norms. Analysis of 21,291 active inventory items revealed that:

- In respect of 1,108 items, the minimum and maximum stock levels were not fixed.

- In respect of 20,240 items, the re-order level and re-order quantity were not fixed and out of these, minimum stock levels were fixed in respect of 20,183 items. Further, in respect of 84 out of these items, the minimum and maximum stock levels fixed were the same.

Thus, absence of input controls led to inconsistent data wherever it was entered and in some cases the specific levels were not fixed which further weakened the inventory management. The Management accepted (May 2008) the observation and stated that necessary corrective action would be taken in the ensuing year.

Inventory codification

2.5.10 As per the codification procedure of the Company, item code consists of nine digits and the first two digits denote the main group to which the item belongs. Data analysis revealed that:

- 1,228 different item codes were used for 435 item descriptions and the multiplicity ranged from 2 to 53, out of these against 69 descriptions were entered as 'blank' and 26 descriptions were entered as "BUSH".
- Out of 26 different item codes indicated against the item "BUSH" only four* codes were identified as capital spares and the remaining 22 items valued at Rs. 4.21 lakh remained in the stock without issue since October 2002 due to non-assignment of specific item description.

The Management admitted (May 2008) the observations and stated that now the codification is being validated by the Maintenance and Planning department. The fact remains that deficiencies crept in initial period were yet to be rectified.

2.5.11 Further analysis of data revealed that:

- Inspection status was not standardised and entries like *INSPECTED, inspected, INSPECTEDD, INXSPECTED, Inspected* and *inpspected* were allowed and the status had not been indicated in 265 cases even though the date of inspection had been mentioned**.**
- Only 4,943 out of 7,565 items inspected were moved to the stock account.
- Miscellaneous cost incurred against a Work Order (2007-08) was incorrectly indicated as Rs. 9.68 crore instead of Rs. 9.68 lakh and the mistake was not rectified till date (September 2008).

Purchase and receipt of goods

2.5.12 Data analysis of purchase, receipt of goods available in the system revealed that:

- In 107 out of 20,968 purchase cases the PO dates were earlier to the purchase request dates by one to 136 days.
- Similarly in 1,602 out of 21,103 cases, the dates of invoices received for the materials purchased were found to be earlier than the purchase order date by one to 2,239 days.

The Management stated (May 2008) that certain POs were placed without waiting for the indents in view of the urgency and in some cases there might be typographical errors. This indicated absence of validation controls. Further,

* Item codes: 501916008, 501916032, 501916036 and 501924016.

the system needed to have separate provisions for urgent or emergency purchases.

2.5.13 Analysis of data relating to goods received and subsequent stock entry revealed the following:

- 1,874 items including 18 rejected items out of 3,122 items yet to be inspected were shown as moved to stock.
- The system accepted the date of inspection and date of goods receipt date as 1899/12/31 in 3,691 and 3,303 cases respectively.
- In one case, system accepted a future date as the inspection date.
- In 951 cases, the inspection date was before unloading of the materials which varied from 1 to 966 days.
- In 239 cases the goods received date was before the inspection date ranging from 1 to 1,094 days.
- In 111 cases the inspection date was indicated after one year from the unloading date. Out of this, in 67 cases, the items were accounted for in the stock account before the inspection.

Thus, there was no validation check on the dates as per the chronology of events. The Management stated (August 2008) that in the absence of provision in the Ramco e-Application to inspect the goods before receipt, a user defined screen was developed to follow the procedure and the user defined process lacked the required validation controls. The necessary controls needed to be provided in the user designed process to avoid such instances.

Work Orders

2.5.14 Analysis of work order status on the 9 January 2008 and the relevant cost details revealed the following:

Sl.No.	WO Status	Number of Records
1.	Cancelled	1,031
2.	Closed	30,099
3.	In Progress	20
4.	Open	2,641
5.	Schedule	492
	Total	**34,283**

- Out of 30,099 closed work orders the cost of execution was available only for 29,037 work orders.
- In 4,522 cases out of 29,037 cases, the scheduled execution dates were earlier than the work order dates by 1 to 928 days.

- In 3,499 cases out of 29,037 cases, the Work Order Completion dates were earlier than work order dates by 1 to 928 days.

Further review of the status in March 2008 revealed that during the period 2,500 work orders were closed and closure dates were indicated as dates prior to 9 January 2008.

This indicated that the entries were manipulated which resulted in generation of inconsistent Management Information System (MIS) reports through the system over a period.

2.5.15 As per the outlined procedure relating to a work order, modification was not possible after closure of the work order. The system, however, had provision for allowing transactions on a closed work order by creating a sub-work order for regularising the unaccounted receipt, issue, returns, etc. of the parent work order.

Audit scrutiny revealed the following:

- In 1,898 work orders, material had been issued after (1 to 473 days) of closure of the respective work orders.

- In 15 cases 'sub-work orders' were generated before the date of the parent work order by one to six days.

- In 11 cases, sub-work orders were generated in the subsequent financial years after the closure of the work order.

Management admitted (May 2008) the deficiency regarding creation of sub-WOs prior to parent WO and stated that the matter had been referred to Ramco Systems Limited. The Management further stated that there was time stamping in the database for recording the actual work order closing date after which no further transactions were possible. It was further stated that the WO completion date as mentioned in the WO was the completion date entered by users whereas the system records the system date in the database. However, any supporting documents/evidence was not provided to audit in the absence of which it could not be vouched.

Non-utilisation of system

2.5.16 It was noticed that though Coal was the major and high value raw material, the accounting of the same was not done through the system. Vendor details and budget details are not updated in the system.

2.5.17 The system was equipped with various inventory analysis tools like ABC Analysis, XYZ Analysis, FSN* Analysis and VED** Analysis. Data analysis revealed that the system was not used for identification of slow/non-moving items of stores/spares.

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* Fast moving, Slow moving and Non-moving items.

** Vital, Essential and Desirable items.

- 1,466 items valued at Rs. 2.12 crore procured more than one year ago (including 343 items migrated in October 2002) had not been issued so far (9 January 2008).

- Further analysis of the data revealed that 771 inventory items valued at Rs. 2.82 crore were not issued during the last three years.

Other issues

Mismatch of figures of Stores Price Ledger

2.5.18 The Stores Price Ledger (SPL) generated through the system contained details of closing stock of inventory including issues, returns and closing balance. Comparison of these details with those available in Inventory Module for the years 2004-07 revealed the following discrepancies:

(Figures are in rupees)

Year	Issue			Return		
	As per IM	As per SPL	Difference	As per IM	As per SPL	Difference
2004-05	14,95,54,547	14,95,54,547	Nil	27,80,068	27,80,068	Nil
2005-06	14,81,64,852	14,81,64,852	Nil	1,01,92,190	1,05,24,335	3,32,145
2006-07	14,77,47,012	14,71,72,298	5,74,714	44,86,556	44,86,556	Nil

Further analysis revealed that certain issues/returns were not taken into account in the SPL. As the closing stock in the financial account was valued on the basis of SPL, this also resulted in overstatement of stock of inventory to the extent of Rs. 3.32 lakh and Rs. 5.75 lakh in the year 2005-06 and 2006-07 respectively.

The Management replied (August 2008) that those material returned under 'unplanned' type (2005-06) and items directly moved to the cost centres were not included in the SPL and hence there was no overstatement of stock. The reply could not be accepted since further checks revealed that the material returned was treated as 'inventory' and the items were issued through stores only and not moved directly to the cost centres.

Available features of the Ramco e-Application

2.5.19 The Company initially purchased and implemented only three modules of the Ramco e-Application System though features like Cash Flow, Accounts Payable, General Ledger, Management Accounting, Fixed Assets etc. were readily available in the off the shelf application. The Company has decided (September 2007) to reengineer and implement an Enterprises Resource Planning (ERP) system using System Application and Products in Data Processing (SAP) at an estimated cost of Rupees five crore (including Rs. 0.35 crore towards development of IT Strategy Roadmap) on account of some drawbacks in the existing system like absence of integration of the existing application with financial accounting, asset accounting, detailed cost accounting etc., and to minimise manual intervention in the business processes. The fact remains that the Company did not explore the possibilities of implementation of similar facilities already available in the existing ERP System.

The matter was reported to the Management/Government (October 2008); their replies were awaited (November 2008).

Conclusion

Though the system was in operation for the last six years the Company did not have any documented IT strategy, IT policy, security and backup policy. The computerisation of different activities of the Company suffered from improper business mapping and codification which were vital for assuring effectiveness of the system. The input and validation controls of the system were not adequate for ensuring accuracy and integrity of data. The system did not have adequate logical access control especially due to deficient number of user licenses which led to lack of accountability on part of the users. As a result, the system remained with deficient data without serving as a reliable Management Information System. Due to non-integration of the system with the finance and account activities, the system was also not helpful in preparing the financial statements.

Recommendations

In order to obviate the shortcomings in the system, the Company should:

- **Frame the IT strategy, security and backup policies;**
- **Map the complete business process in the system;**
- **Codify and fix the levels of inventory;**
- **Strengthen the input and validation control features; and**
- **Strengthen the logical access controls especially by using adequate number of licenses and allocation of specific roles and authorisation rights to ensure accountability.**