CHAPTER-II

PERFORMANCE REVIEW RELATING TO GOVERNMENT COMPANY

2 TAMIL NADU NEWSPRINT AND PAPERS LIMITED

PRODUCTION AND SALE OF PAPER

HIGHLIGHTS

The Company was promoted by the Government of Tamil Nadu for production of newsprint and printing and writing paper using bagasse as the main raw material.

(Paragraph 2.1)

The Company had tie-up agreements with nine sugar mills for supply of the entire quantity of bagasse generated by them, on barter system basis in exchange of steam/coal. Though the Company fulfilled all its contractual obligations, the sugar mills did not supply the entire quantities of bagasse generated. This resulted in use of costlier imported pulp at an extra expenditure of Rs.57 crore.

(Paragraph 2.8)

Failure to adhere to the budgeted norms of pulp consumption resulted in extra expenditure of Rs.60.20 crore.

(Paragraph 2.12)

Failure to limit the finishing loss in paper production to the budgeted ceilings resulted in extra expenditure of Rs.33.67 crore during the five years ended 31 March 2006.

(Paragraph 2.14)

Modernisation of the paper machines at a total cost of Rs.105.76 crore did not yield the desired results. The Company's failure to achieve the envisaged machine speed in Paper Machines 1 and 2 after modernisation resulted in contribution loss of Rs.112.75 crore.

(Paragraphs 2.18, 2.20 and 2.21)

Grant of discount applicable to sale of note book scheme on sales under some other scheme resulted in irregular payment of discount of Rs.1.09 crore.

(Paragraph 2.31)

Introduction

2.1 Tamil Nadu Newsprint and Papers Limited (Company) was set up by the Government of Tamil Nadu for the manufacture of newsprint (NP) and printing and writing paper (PWP) using sugarcane bagasse[♣] as the raw material. The paper mill was commissioned (October 1985) at Pugalur in Karur district with an installed capacity of 90,000 tonnes *per annum* (TPA). The mill commenced production in 1986 and is the only unit in the State to manufacture paper from bagasse pulp. The capacity of the mill was doubled in 1992 by installing a second paper machine. During 2002-03, both the existing paper machines were upgraded increasing the installed capacity to 2,30,000 TPA.

The performance of the Company was last reviewed in the Report of the Comptroller and Auditor General of India (Commercial) – Government of Tamil Nadu for the year ended 31 March 1988. The review was discussed by the Committee on Public Undertakings (COPU) in 1993-94 and its recommendations are contained in the 158th and 269th report tabled in the Legislative Assembly of Tamil Nadu on 19 March 1994 and 9 November 1995 respectively.

Scope of audit

2.2 A Performance Audit of the activities of the Company on Production and sale of paper during the five years from 2001-02 to 2005-06 was conducted through test check of records maintained at the Head Office of the Company at Chennai, the paper mill of the Company in Pugalur and three out of nine marketing offices during December 2005 to April 2006.

Audit objectives

2.3 The performance audit was conducted with a view to ascertaining whether:

- the facilities established for manufacture of newspaper and printing and writing paper were utilised to the optimum level and wastages were within the budgeted norms fixed by the Company;
- the procurement of raw material for the manufacture of paper was made economically, efficiently and the consumption of raw material was as per the budgeted norms;
- modernisation and upgradation of paper machines helped in achieving the increased capacity;
- the utilisation of steam and power, *etc*., for the manufacture of paper was within the budgeted norms; and
- the Company was able to market its products effectively and at reasonable prices to maximise its earnings.

♣ Bagasse is the residue left after extracting the juice from sugarcane.

Audit criteria

2.4 The audit criteria used for assessing the achievement of audit objectives were:

- targets laid down by the Company for capacity utilisation, budgeted norms for wastages, consumption of raw material, steam, power, *etc*.
- agreements entered into by the Company with various sugar mills for procurement of bagasse on barter basis (in exchange of coal/steam supplied by the Company);
- agreements for purchase of bagasse and hard wood pulp from the open market;
- marketing policy of the Company.

Audit methodology

2.5 The audit methodology adopted for attaining the audit objectives with reference to audit criteria were examination of:

- agenda and minutes of meetings of the Board of Directors;
- records relating to fixation of installed capacity and utilisation there against;
- records relating to actual production, wastage, usage of raw material with reference to targets/ budgeted norms;
- records relating to purchase of bagasse on barter system and purchase of bagasse and hard wood pulp from the open market;
- records relating to modernisation and upgradation of paper machines;
- records relating to sale of papers;
- issue of audit observations and
- interaction with the management.

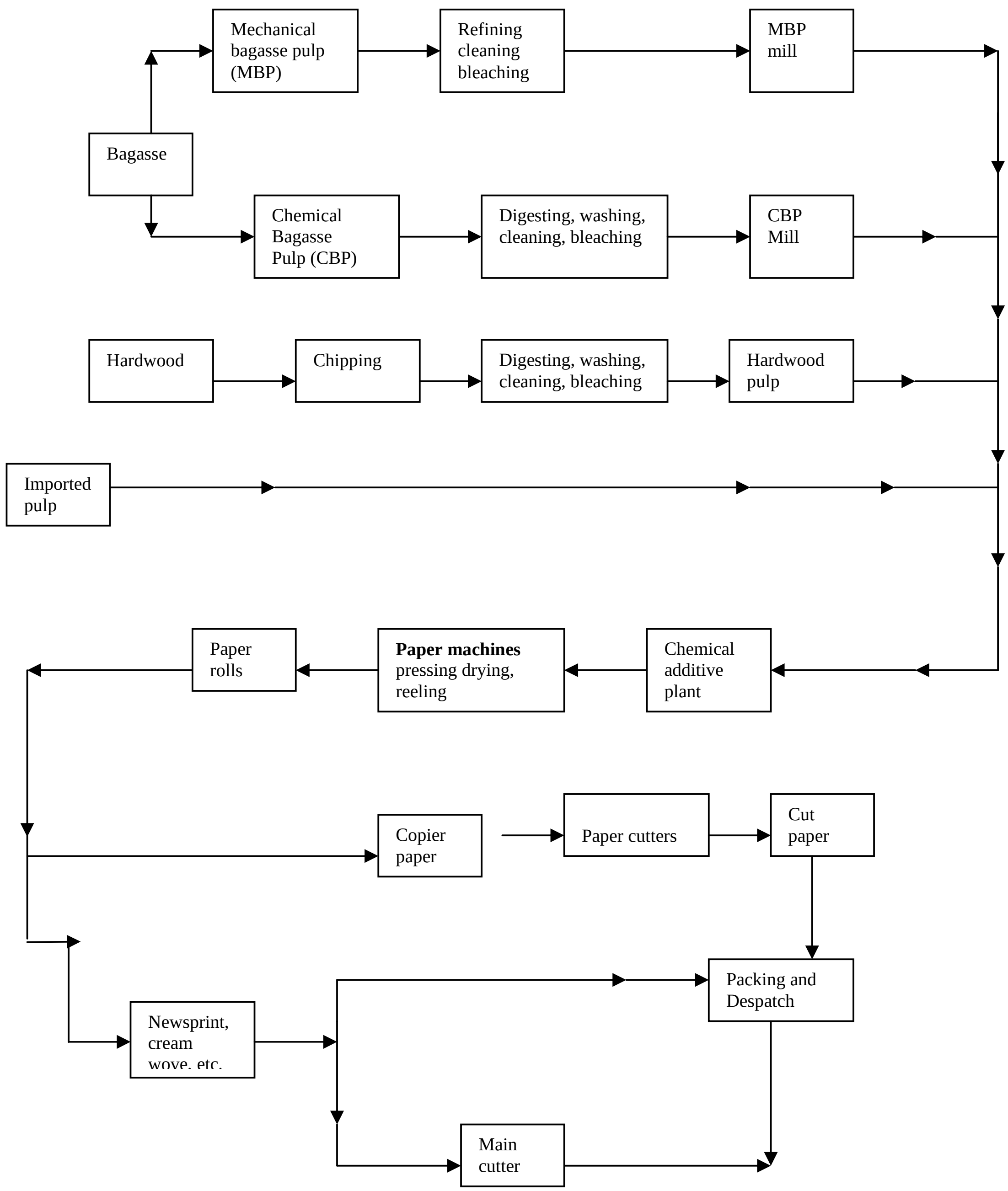
Audit findings

Audit findings, emerging as a result of test check were reported to the Government/Company in June 2006 and were also discussed in the meeting of the Audit Review Committee on Public Sector Enterprises held on 28 August 2006. The Secretary, Industries Department, Government of Tamil Nadu and the Managing Director of the Company attended the meeting. The views expressed by the management and the Government have been taken into consideration while finalising the report.

Paper making process

2.6 The flow chart on the processes involved in production of paper is given below:

Process flow chart in paper production



The process, in brief, involves production and mixing of bagasse pulp, hard wood pulp and imported pulp with chemicals before being rolled into paper by pressing and drying. The paper is then sorted out as copier paper, newsprint and other types and packed after cutting into desired sizes.

Audit findings arising from the performance review are discussed in the succeeding paragraphs:

Procurement of raw materials

Procurement of bagasse

2.7 Depithed bagasse is the main raw material used for production by the Company and sugar mills are the main sources of supply of this raw material. Every MT of sugarcane crushed yields approximately 26 percent of wet whole bagasse, which on depithing yields 70 *per cent* of depithed bagasse. In order to produce 2,30,000 MT of paper *per annum* (installed capacity), the Company requires 7 lakh MT of depithed bagasse equivalent to 10 lakh MT of wet whole bagasse. The Company entered into agreement with the sugar mills for the procurement of bagasse in exchange of coal/steam. Based on the crushing capacity of the sugar mill, the Company estimated the quantum of bagasse that could be procured from each mill. The estimate is necessary for deciding the investments in boilers and other assets to be set up by the Company in the sugar mills and for determining the extent of purchase of bagasse required to be made from the open market or through import, in case of shortage in procurement from the sugar mills. Shortage, if any, in procurement of bagasse from the sugar mills also affects the cost of procurement as the alternate sources of open market and import are costlier.

2.8 The Company had entered into agreements with 9 out of 32 sugar mills in the State for supply of bagasse (with four mills to procure bagasse on steam exchange basis and with five mills on fuel *viz*., coal, on exchange basis). The agreements with the sugar mills provided for supply of the entire quantity of bagasse generated by them to the Company. It was, however, observed during audit that five sugar mills with whom the Company had entered into tie up arrangements did not supply the entire bagasse generated by them as detailed below:

(In lakh MT)

Name of the mill	2001-02		2002-03		2003-04		2004-05		2005-06	
	Generated*	Supplied	Generated	Supplied	Generated	Supplied	Generated	Supplied	Generated	Supplied
Sakthi Sugar	2.36	2.03	---	---	---	---	---	---	---	---
EID Parry, Pugalur	1.62	0.69	0.96	0.34	0.25	0.02	0.43	0.19	1.33	0.32
EID Parry, Pettavaithalai	1.08	0.72	0.82	0.54	0.34	0.21	---	---	1.15	0.63

* Cane crushed X 26 per cent bagasse generation X 70 per cent depithed bagasse.

Name of the mill	2001-02		2002-03		2003-04		2004-05		2005-06	
	Gene-rated*	Supp-lied	Gene-rated	Supp-lied	Gene-rated	Supp-lied	Gene-rated	Supp-lied	Gene-rated	Supp-lied
Thiru Arroran, Thirumandakudi	---	---	---	---	---	---	0.92	0.42	---	---
Auro Energy, Tuhili	---	----	----	----	0.51	0.47	0.57	0.52	---	---

(Figures provided only in case of short supply)

Non-supply of the entire quantity of bagasse generated by the sugar mills resulted in use of costlier imported pulp at an extra expenditure of Rs.57 crore.

In paper production, bagasse pulp, indigenous wood pulp and imported wood pulp are used in fixed proportions. As the shortfall in supply of bagasse had to be made good by the use of costlier imported pulp, non-supply of the entire bagasse generated by the sugar mills resulted in avoidable extra expenditure of Rs.57 crore on account of procurement of costlier imported pulp during the five years ended 31 March 2006. The Company could not take any remedial action, as the agreements did not contain penal provisions for non-supply of the envisaged quantum of bagasse.

Audit analysis of the agreements made by the Company with the sugar mills for procurement of bagasse on barter system basis revealed the following:

Sakthi Sugars Limited (SSL), Appakkudal

2.8.1 The Company had installed boilers at SSL, Appakkudal and supplied coal for use in these boilers. As per the agreement, the Company had to procure coal and supply the same to SSL. However, during 2003-04 and 2004-05, at the request of SSL to make its own arrangements for importing coal, the Company agreed and paid the cost of coal along with the cost of transportation as if the coal was received at its Pugalur plant and then reloaded and transported to SSL. In addition, the Company also paid administrative charges, driage of coal, *etc*. This resulted in extending undue benefit of Rs.1.53 crore to SSL. Further, by allowing SSL to make its own arrangements for coal, the Company also paid Rs.22.64 lakh for the empty return trips of the vehicles transporting bagasse.

The Government stated (July 2006) that the payment to SSL was restricted to the cost of imported coal plus the other incidental expenses and the cost per MT paid to SSL was less than the expenditure incurred by SSL. The reply is not tenable as the Company should have reimbursed only the cost of coal and transportation charges from Tuticorin Port to SSL, Appakudal, instead of reimbursing the cost of coal as if the same was received at its Pugalur Plant and was then transported to Sugar Mill at Appakudal.

Non-review of coal prices and ocean freight as envisaged in the agreement resulted in undue benefit of Rs.0.25 crore to the sugar mill.

2.8.2 As per the agreement, coal cost to be reimbursed to the mills in lieu of bagasse was to be reviewed every three months. Such a review was due during March 2005. But no such review was conducted even though the coal prices and ocean freight were showing a declining trend. Non-review of the cost by the Company resulted in undue benefit of Rs.24.53[♣] lakh to the SSL during April to July 2005.

The Government stated (July 2006) that the Company had reviewed the coal cost periodically. The reply is not acceptable as it was noticed that though the coal prices started declining from March 2005 onwards, the Company failed to take note of this declining trend and revise the cost to be reimbursed and continued to reimburse at the rates fixed for the earlier three months, *viz*., January to March 2005.

Payment of transportation charges not covered by the agreement resulted in undue benefit of Rs.1.31 crore to the sugar mill.

2.8.3 Whenever SSL, Appakudal did not have sufficient quantity of sugarcane, it made arrangements for diversion of sugarcane from its sister unit at Sivaganga and claimed the transportation cost for such diversions. The Company paid Rs.1.31 crore during 2003-04 and 2004-05 on this account. SSL, Appakkudal was bound to supply bagasse to the Company and as such payment of transportation charges not covered by the agreement lacked justification.

The Government stated (July 2006) that the Sivaganga unit of SSL diverted the sugarcane to Appakudal at the request of the Company for supplying bagasse. Hence, the transportation charges involved in the diversion of sugarcane from Sivaganga to Appakudal were borne by the Company. The reply is not acceptable, as the payment of transportation charges for sugarcane from one unit to another unit of SSL was not covered by the terms of agreement.

Retrospective revision of steam bagasse exchange ratio resulted in undue benefit of Rs.3.35 crore to the sugar mill.

2.8.4 The Company had installed boilers and other accessories in the sugar mill to supply the required quantum of steam in exchange of bagasse. Though the Company supplied steam/coal as per the tie-up arrangement, SSL did not supply the full quantum of bagasse and there was a net shortfall to the extent of 1,00,757 MT valued at Rs.7.45 crore during the period 1987-88 to 2002-03. The Board of the Company waived (March 2006) 45 *per cent* of this amount retrospectively by revising the steam bagasse exchange ratio from 2.10:1 in 1987-88 to 2.18:1 in 2002-03. This resulted in undue benefit of Rs.3.35 crore to SSL. Even after such a waiver, the balance amount of Rs.4.10 crore was still to be recovered (March 2006) from SSL.

The Government stated (July 2006) that SSL demanded retrospective revision of power charges payable by the Company to SSL at par with the Tamil Nadu Electricity Board (TNEB) rates and premium for supplying bagasse from its enhanced sugarcane crushing capacity. It was further stated that as acceptance of such demands would have led to similar demands from other sugar mills, which supply bagasse to the Company, the above waiver was made.

The reply is not acceptable as the Company was to pay power charges as stipulated in the agreement for their installations located in the mill based on the actual cost of power. Though the actual cost of power calculated as per the

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♣ Quantity of coal supplied during April to July 2005 – 28,127.22 MT. Reimbursed rate at US $ 53 per MT. Prevailing rate – US $ 51 per MT. Exchange rate Rs.43.60 per US $.

cost accounting rules was less than 55 paise per unit, the Company had been reimbursing the sugar mill at 55 paise per unit due to a provision in the agreement. The demand for premium payment for the enhanced supply of bagasse is also not tenable as the quantum of 3.30 lakh MT of wet whole bagasse envisaged in the agreement was never supplied by SSL even after the increase in capacity. Further, since the contract did not contain any penal provision for short supply of bagasse, the waiver given by the company in lieu of the claim for premium for the anticipated supply of excess quantity of bagasse was not justified.

EID Parry, Pettavaithalai

2.8.5 The Company entered into an agreement with EID Parry (India) Limited, Pettavaithalai for the supply of bagasse in exchange of steam supply by the Company. During 2002-03 to 2004-05, as compared to the quantum of steam supplied by the Company, there was shortfall in supply of 55,246.641 MT bagasse by EID Parry Pettavaithalai. In order to make good the shortfall, EID agreed to adjust the surplus bagasse of 22,977 MT lifted from its other units at Pudukottai, Nellikuppam and Pugalur. Even after adjustment of this quantity, there was balance quantity of 32,269.64 MT of bagasse still to be adjusted. Despite this, the Company procured quantity of 9,046 MT and 4,183 MT from Nellikuppam and Pudukottai respectively during 2004-05, at open market prices, instead of adjusting the same against the balance quantity of bagasse due from Pettavaithalai unit. As the open market prices were higher than the tie up rate applicable for Pettavaithalai unit, the procurement resulted in an avoidable expenditure of Rs.1.27 crore.

The Government stated (August 2006) that had the bagasse not been procured at open market prices, the Company would have been forced to use imported pulp. The reply is not acceptable as EID had agreed to meet the shortfall and the Company should have adjusted the supply against shortfall instead of paying at the market rates.

EID Parry Limited, Pugalur

Acceptance of higher steam bagasse ratio for EID, Pugalur resulted in less procurement of bagasse valuing Rs.1.14 crore.

2.8.6 In the agreement entered into by the Company with this sugar mill, the steam bagasse ratio was indicated as 2.18:1 against the ratio of 2.1:1 applicable for other sugar mills having similar boiler capacity. Acceptance of a higher steam bagasse ratio for this mill had deprived the Company of 5,225 MT of bagasse valued at Rs.1.14 crore during the five years ended 31 March 2006.

2.8.7 Considering that the proximity of Pugalur sugar mill would bring reduction in procurement cost, the Company agreed to bear 85 *per cent* of the boiler cost instead of the normal 50 *per cent*. Audit analysis, however, revealed that the envisaged benefit of lower procurement cost of bagasse was not achieved as the cost of procurement from Pugalur was the highest at Rs.4,735 per MT in 2003-04 and Rs.1,818 per MT in 2004-05. Thus, the decision of the Company to bear 85 *per cent* of the boiler cost did not yield the desired result leading to an undue benefit of Rs.10.50 crore to EID, Pugalur. It is pertinent to mention in this connection that the Company did not get the entire bagasse generated by this unit as envisaged in the agreement. Further, the Company is yet (March 2006) to recover Rs.60.70 lakh from EID, Pugalur towards the excess cost of steam supplied to them.

Supreme Renewable Energy Limited, Pennadam

2.8.8 The Company entered (September 2003) into an agreement with Supreme Renewable Energy Limited, Pennadam for procurement of bagasse in exchange of steam. The agreement was valid for 17 years but the agreement was prematurely closed in January 2006 at the request of the sugar mill. The Company had to recover Rs.1.75 crore from the sugar mill after adjusting their various dues. This amount is yet to be recovered by the Company. Further, an amount of Rs.68.65 lakh towards interest on advance paid to the mill is also recoverable from them but the same has not been recovered (August 2006).

Open market purchases

Extra expenditure on purchase of bagasse

2.9 The Company resorted to open market procurement of bagasse whenever there was shortfall in the receipt of bagasse from the tied up sources. The Company procured 13,703 MT of bagasse in 2003-04 from Bannari Amman Sugar Mills Limited (BAS) on open market purchase basis. In addition to the payment for bagasse, the Company paid Rs.1.47 crore as compensation to this mill on the ground of use of coal as fuel instead of bagasse. Such compensation was unwarranted in the case of open market purchases.

The Government stated (July 2006) that in order to tide over the shortage of bagasse, the Company had planned procurement from BAS on fuel substitution basis and got the entire bagasse from that unit. The reply is not acceptable as the boiler in BAS was a coal fired one and the payment of Rs.1.47 crore as compensation for use of coal to BAS lacked justification, as the mill was otherwise using only coal as fuel. It is interesting to note that during the 2004-05 sugar season, the Company procured 33,757 MT of bagasse from the same source on open market basis without giving compensation for fuel substitution.

Production performance

2.10 The production performance of the Company during the five years ended 31 March 2006 is given below:

	2001-02	2002-03	2003-04	2004-05	2005-06
Installed capacity (MT)	1,80,000	1,80,000	2,30,000	2,30,000	2,30,000
Production (MT)	1,84,267	1,67,878	1,82,215	1,96,241	2,30,079
Capacity utilisation (in *per cent*)	102.37	93.26	79.22	85.32	100

2.11 As part of the budgetary exercise and control, the Company prepares an annual budget for the production and consumption of various consumables like pulp and chemicals and utilities like steam and power. The performance of the Company vis-a-vis norms fixed by the Company is discussed in the following paragraphs:

Pulp consumption

Variance in consumption of pulp mix compared to the budgeted norms resulted in extra expenditure of Rs.60.20 crore.

2.12 The Company had fixed norms for consumption of pulp mix *viz*., mechanical bagasse pulp (MBP), chemical bagasse pulp (CBP), hard wood pulp and imported wood pulp in the production of news print and printing and writing paper. The Company, however, did not adhere to the budgeted norms of pulp mix in the last five years and the percentage of excess over the budgeted norms ranged from 12 to 218 *per cent.* The Company used hard wood pulp and imported pulp, which are costlier than the bagasse pulp, far in excess of the budgeted norms. This resulted in an extra expenditure of Rs.60.20 crore during the five years ended 31 March 2006 as detailed in **Annexure-9**. It is pertinent to mention that in spite of increased and substantial availability of bagasse during 2005-06 as compared to earlier years, the Company increased the content of costlier imported pulp from 8 *per cent* in 2004-05 to 17 *per cent* in 2005-06. The Company actually consumed 16 *per cent* of imported pulp in paper production in that year.

The Government stated (July 2006) that the actual pulp production vis-a-vis targeted pulp production should be reckoned and not the pulp mix. Pulp mix depends on the condition of the paper machine, actual operating speed, products and other factors. The reply is not acceptable, as the target of pulp mix would have been arrived at only after considering all these aspects. Further, any adverse variance in the pulp mix results in increase in cost of production.

Consumption of chemicals

2.13 Consumption of chemicals in the three pulp mills *viz*., MBP mill, CBP mill and hard wood pulp mill and in the paper making process were in excess of the budgeted norms as detailed in **Annexure-10**.

Excess consumption of chemicals in pulp and paper production led to extra expenditure of Rs.16.94 crore.

From the annexure, it can be seen that the Company kept on changing the budgeted norms for consumption of various chemicals from year to year. In spite of this, the consumption of chemicals was in excess of the norms in maximum number of chemicals. Based on the cost of chemicals and the paper production in the respective years, the excess consumption of chemicals resulted in additional expenditure of Rs.9.48 crore in the pulp mills and Rs.7.46 crore in paper production during the five years ended 2005-06.

The Government stated (July 2006) that the poor quality of water resulting from use of recycled water as a measure of water conservation and poor quality of bagasse resulted in excessive usage of chemicals. The reply is not acceptable as the Company itself had stated (August 2005) that poor quality of chemicals used in the pulp and paper making process resulted in higher consumption of chemicals.

Excess finishing loss

2.14 Finishing loss may occur due to various factors like loss at winder, loss due to roll and winder breaks, left over paper on jumbo, crease and corrugation problems, loss at rewinder, loss at cutter and finishing, core end and reel top, cutter breaks, *etc*. The rejected paper is sent to the pulp mill for re-pulping.

There were no industry norms available with the Company for the finishing loss. Every year, the Company fixes the budgeted ceiling for finishing loss. There were wide variations in the ceilings fixed for newsprint from year to year. The actual finishing loss in terms of percentage of production had been very high vis-a-vis budgeted ceilings as detailed below:

(Percentage of production)

Year	Budgeted ceilings			Actuals		
	Newsprint	PWP-PM-1	PWP-PM-II	Newsprint	PWP-PM-I	PWP-PM-2
2001-02	4.80	11.00	9.50	7.03	12.16	11.13
2002-03	6.50	9.99	10.09	8.45	12.62	11.55
2003-04	9.00	10.81	10.00	5.34	15.42	11.39
2004-05	5.50	11.00	9.00	4.45	11.67	10.24
2005-06	4.00	10.65	9.40	6.83	11.27	9.69

Excess finishing loss over the norms resulted in extra expenditure of Rs.33.67 crore.

Audit analysis revealed that the main reasons for the higher finishing loss were crease and corrugation, excess trim loss and excess left over quantity due to usage of non-uniform diameter reels. Computed with reference to the production in the respective years, the excess finishing loss had resulted in incurring of extra expenditure of Rs.33.67 crore on repulping during the five years ended 31 March 2006.

The Government stated (July 2006) that the finishing loss is machine specific and depends on the machine condition, quality of input materials, pulp furnish, quality of water, quality requirement of end paper, small width reels and ratio of reels to sheets. The reply is not tenable as these factors would have been taken into account while fixing the ceilings. The Government also stated that the Company would keep the finishing loss within the budgeted levels in future.

Excess retree generation

2.15 Retree is the material rejected by the Quality Control Department during the production of paper. This is sold in the market at lower rates, by giving discount. The percentage of retree varies from machine to machine because of the machine conditions, furnish change, grade change, operational parameters, *etc*. The Chairman-cum-Managing Director of the Company fixed

(September 2001) the ceiling for retree generation as five percent in the case of PM-1 and three *per cent* for newsprint and three and half *per cent* for PWP in the case of PM-2. As against these ceilings, actual retree generation ranged between 6.50 and 19.60 *per cent* during the five years ended 31 March 2006.

Audit analysis revealed that poor quality of bagasse fibre and poor dimensional stability were the main reasons for higher retree generation. Poor reels condition, crease and corrugation in paper also contributed to the higher retree generation as discussed in Paragraph 2.19 *supra*. The Company has not been able to reduce these deficiencies so far. Failure to maintain the retree generation within the ceilings resulted in revenue loss of Rs.3.53 crore during the five years due to selling of paper at discount as detailed below:

Year	Equivalent Finished Production	Retree generation in percentage			Excess retree generation in MT (2X5)	Average discount (Rupees per MT)	Revenue loss (Rupees in lakh) (6X7)
		Ceilings	Actuals	Excess			
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
PM-1							
2001-02	84,293	5	14.94	9.94	8,379	500	41.89
2002-03	75,870	5	17.07	12.07	9,158	500	45.79
2003-04	81,711	5	19.60	14.60	11,930	500	59.65
2004-05	95,125	5	7.76	2.76	2,625	1000	26.25
2005-06	1,07,805	5	8.60	3.60	3,881	1,000	38.81
PM-2							
2001-02	66,380	3.5	9.95	6.45	4,282	500	21.41
2002-03	70,290	3.5	11.57	8.07	5,672	500	28.36
2003-04	92,107	3.5	9.06	5.56	5,121	500	25.60
2004-05	93,773	3.5	6.84	3.34	3,132	1,000	31.32
2005-06	1,15,264	3.5	6.50	3.00	3,458	1,000	34.58
Total loss due to Excess Retree generation							**353.67**

The Government stated (July 2006) that water shortage, use of recycled water and problems faced in the paper machine after upgrade/speed up were the reasons for higher retree generation and assured that this would be brought down substantially in the years to come. The reply is not tenable as these factors would have been taken into account while fixing the budgeted ceilings.

Cutting loss

2.16 The Company installed (April 2000) Bilomatic cutter machine and ECH WILL cutter (February 2003) to increase the production of cut size packs of copier paper. It was noticed in audit that these cutting machines did not work to their full capacity since inception. Further, the cutting loss was also very high and it ranged from 5.05 to 11.69 *per cent* in Bilomatic cutter and from 5.11 to 11.39 *per cent* in ECH WILL cutter as against the ceiling of 4.0 *per cent*. The excess cutting loss over and above the ceiling resulted in extra expenditure of Rs.8.18 crore for repulping the cutting loss as detailed below:

Year	Paper input (In MT)	Cutter loss in percentage			Excess cutting loss (In MT) (2X5)	Cost of repulping (Rupees per MT)	Extra expenditure (Rupees in lakh) (6X7)
		Ceilings	Actuals	Excess			
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Bilomatic cutter							
2001-02	12,398	4	9.18	5.18	642	17,197	110.41
2002-03	11,911	4	9.45	5.45	649	17,403	112.95
2003-04	6,033	4	11.69	7.69	464	19,234	89.25
2004-05	8,923	4	9.99	5.99	535	18,362	98.24
2005-06	10,803	4	5.05	1.05	113	17,446	19.71
ECH WILL cutter							
2003-04	12,974	4	11.39	7.39	959	19,234	184.46
2004-05	19,814	4	8.22	4.22	836	18,362	153.51
2005-06	25,792	4	5.11	1.11	286	17,446	49.90
TOTAL							818.43

The Government stated (July 2006) that poor quality of paper was the major reason for higher cutting loss. Audit analysis, however, revealed that apart from the poor quality of paper, longer downtime due to frequent change of production from A4 to A3 size and A3 to Folio size, frequent equipment failures and rough cutting, which were all controllable, were the main reasons for higher cutting loss.

Modernisation of paper machines(PM)

2.17 In the year 2002, the Company undertook modernisation of PM-1 and PM-2 with a view to eliminate operational bottlenecks and to increase the installed capacity of the mill from 1,80,000 MT to 2,30,000 MT. The modernisation programme, *inter alia*, included rebuild of PM-1 and speed up of PM-2.

Rebuild of Paper Machine-1

2.18 With a view to improving the efficiency of the paper machine and to operate the paper machine at high speed during the manufacture of surface size grade paper, the Company took up rebuild of PM-1. The Company completed the rebuild of PM-1 during September to December 2002 at a total cost of Rs.52.21 crore.

The Company failed to achieve the guaranteed machine speed after rebuild resulting in loss of contribution of Rs.22.24 crore.

It was observed in audit that the envisaged speed of 660 meter per minute (mpm) for 60 GSM surface size paper was not achieved even after modernisation and the actual speed achieved ranged from 612 to 624 mpm. Computed with reference to the actual production per hour achieved each year, failure to achieve the envisaged speed resulted in production shortfall to the extent of 6,241 MT and 6,245 MT respectively during 2003-04 and 2004-05. In December 2005, the Company fixed benchmark speed for other than copier paper production for above and below 60 GSM at 650 and 700 mpm respectively. The Company even failed to achieve this benchmark speed resulting in production shortfall of 5,345 MT during 2005-06. The shortfall in production during the three years ending 2005-06 resulted in contribution loss of Rs.22.24 crore.

Audit analysis further revealed that the machine speed of PM-1 was low due to the weak frame of the machine, which vibrated at higher speeds. Further, during higher usage of CBP, rigidity drops when the machine is operated at high speed affecting the runability of the machine.

The Board of Directors were informed in December 2005 *i.e.*, after three years of rebuild, about the various problems in the machine like the head box problems, size press and quality related issues which continued to remain. A technical audit conducted (April 2006) by METSO Paper, Thailand, suggested (July 2006) remedial measures that were required to be taken at various sections of PM-1 on priority basis.

Failure to replace head box

2.19 The Company appointed (August 2000) Omni Continental (Omni) to conduct technical audit of PM-1. Omni, *inter alia*, suggested (August 2000) replacement of head box with a modern one. The Company sought the opinion of Sandusky, the original supplier of PM-1, who stated (July 2001) that the head box had been badly damaged and recommended its replacement with a new electro polished unit. In spite of these clear recommendations, the Company instead of replacing the head box, decided to opt for short term measure of reconditioning. The reconditioning was completed at a cost of Rs.1.95 crore (November 2002). As the problem of crease and corrugation in the final product continued even after reconditioning, the Board of Directors were informed (December 2005) that there was an urgent need for replacing the head box with state-of-art dilution type one. The consultants (METSO) among other things recommended (July 2006) to replace the existing head box with a new one equipped with dilution control system.

The Government stated (July 2006) that replacement of head box involved huge capital, change of machine layout and long machine shut down to carryout the changes and hence the Company opted for repair of head box. The reply is not acceptable as even after repair of head box, quality problems like crease and corrugation continued resulting in excess retree generation and increase in finishing loss. Thus, the reconditioning of the head box at a cost of Rs.1.95 crore had not yielded the desired results.

Rebuild of size press of PM-1

2.20 In order to improve the machine running for sized grades of paper and to improve the sizing quality, the Company carried out (July 2003) rebuild of the existing size press in PM-1 at a cost of Rs.24.02 crore. Though rebuild of the size press was to help in reducing the two sidedness of the paper, this quality complaint, however, continued to persist as is evident from the technical Audit report of METSO, Thailand (April 2006).

The Government stated (July 2006) that the installation of size press had helped the Company to produce surface sized paper in large quantities which in turn increased the market share of the Company and that two-sidedness had never been a quality complaint warranting price reduction or compensation. The reply is not acceptable as the installation of size press was to reduce the two sidedness of the paper but this quality complaint still persisted as is evident from the agenda note submitted (December 2005) to the Board of Directors.

Speed up of PM-2

2.21 The main objective of speed up of PM-2 was to increase the machine operating speed from the existing level of 750 mpm to 900 mpm. The Company completed the speed up programme during 2002-03 at a total cost of Rs.29.53 crore.

The Company failed to achieve guaranteed machine speed after speed up resulting in loss of contribution of Rs.90.51 crore.

PM-2 achieved the machine operating speed of 693 and 713 mpm during 2003-04 and 2004-05 respectively against the envisaged speed of 900 mpm. During 2005-06, the Company fixed benchmark speed at 800 mpm for PWP above 60 GSM and at 860 mpm for PWP less than or equal to 60 GSM. It was, however, observed during audit that even this reduced speed was not achieved in 2005-06. Failure to achieve the envisaged speed and benchmark speed after rebuild resulted in production loss of 31,035 MT, 21,409 MT and 14,216 MT of PWP during 2003-04, 2004-05 and 2005-06 respectively with corresponding contribution loss of Rs.90.51 crore. It was noticed in audit that poor fan pump capacity in PM-2 is the major constraint in improving the speed.

2.22 During the speed up of PM-2, two shells failed prematurely due to poor design and quality. As these failures occurred during the warranty period, the supplier should have replaced the shells free of cost. The supplier, however, charged Rs.3.79 crore for these two shells. The Company also agreed and adjusted this amount against liquidated damages recoverable from the supplier for shortfall in guaranteed performance. The payment for prematurely failed shells during the warranty period resulted in extension of undue benefit to the supplier.

Quality control system

2.23 The Company upgraded the Quality control system (October 2002) in PM-2 by adding a colour control system as the existing system was found inadequate after speed up of PM-2. The colour control system (valuing Rs.40

lakh) was installed with a view to facilitate on line control of colour/shade of paper without human intervention. This system, however, could not be satisfactorily commissioned so far, thus, rendering the investment unfruitful.

The Government stated (July 2006) that the supplier is being asked regularly to rectify the defects. The reply does not explain why the defects in the system persist even after four years of supply and what action the Company proposes to take against the supplier in this regard.

Utilities

The main utilities in the production of paper are steam and power. A review of these utilities revealed the following:

Performance of the steam boiler

2.24 The pulp mill, soda recovery plant and paper machine need Low Pressure (LP) steam and or Medium Pressure (MP) steam for process. The required steam is generated using solid fuels like coal, pith, lignite and agro fuels in varying proportion.

The Company has five boilers for production of steam out of which four have a capacity to produce 60 MT of steam per hour each, while the fifth boiler can produce 90 MT of steam per hour. The Company had fixed efficiency levels for these boilers. It was noticed that none of the boilers achieved the budgeted throughput (quantity of steam generated per hour) in any of the five years ended 31 March 2006 (details in **Annexure-11)**.

Failure to achieve the budgeted efficiency in boilers led to extra expenditure of Rs.33.16 crore.

It was noticed in audit from the minutes of the Board meeting held in April 2006 that high cold water temperature due to break down of cooling towers and low condensation power generation from turbo generators resulted in low throughput from boilers. The efficiency of boilers also got affected due to feeding of wet fuel. Failure to achieve the budgeted levels of efficiency led to short fall in generation of steam aggregating to 10,52,417 MT and consequent loss of power generation to the extent of 327 million units valued at Rs.33.16 crore, which could have been earned by the Company by selling the surplus power to Tamil Nadu Electricity Board.

Steam

2.25 The pulp mill, soda recovery plant and paper machines need steam for process. The Company has fixed budgeted norms for the steam in each such process. Audit analysis revealed that the actual consumption of steam was in excess of such budgeted norms by 0.29 MT to 0.34 MT of steam per tonne of paper/pulp production in PM-1, by 0.01 to 0.05 MT in PM-2 and by 0.01 to 0.34 MT in pulp mills during the period of five years ending 2005-06 (details in **Annexure-12**). Computed with reference to the cost of steam generation in the respective years and after allowing a variance up to 10 *per cent*, such excess consumption resulted in an additional expenditure of Rs.10.94 crore during this period. The Government stated (July 2006) that the specific consumption norms in the budget were fixed at a level better than the best achieved in the past so as to exert pressure and reduce consumption further. The reply is not factually correct as the budgeted levels of consumption were more than even the worst performance in PM-1 for production of PWP, low and medium pressure steam in soda recovery plant. To cite a specific example, for production of PWP in PM-1, the lowest consumption of steam was 1.69 MT and the highest was 1.80 MT. The Company, however, fixed the benchmark consumption as 2.20 MT, which was 20 *per cent* more than the worst performance.

Excess consumption of steam and power over the norms resulted in extra expenditure of Rs.15.36 crore.

Power

2.26 For in-house requirement of operation of various machines, the Company needs power. Audit analysis revealed that the actual consumption of power exceeded the budgeted norms and the excess consumption in PM-1 ranged between 8 and 33 KWH per MT of paper/pulp production, in PM-2 between 10 and 55 KWH and in the pulp mills it ranged between 7 and 53 KWH (details in **Annexure-13)**. The excess consumption of power computed with reference to the cost of power generation of the respective years and after allowing a variance up to 10 *per cent* resulted in an extra expenditure of Rs.4.42 crore during the five years ended 2005-06.

The Government stated (July 2006) that the frequent sheet breaks and threading problems resulted in frequent start and stop of the machine. Due to idle running of the machine during paper breaks, the specific consumption of steam and power was higher. The reply is not acceptable since all these were controllable by the management.

Sale of paper

Sales performance

2.27 The major products sold by the Company are NP and PWP. The major channels of sales are direct sales, sales through dealers and exports. The details of sales effected through the three channels during the five years ended 31 March 2006 are given below:

(Quantity in MT)

Year	Direct sale	Percentage	Sales through indentors	Percentage	Export	Percentage	Total
2001-02	28,051	18.67	95,121	63.30	27,087	18.03	1,50,259
2002-03	37,584	25.50	83,927	56.95	25,871	17.55	1,47,382
2003-04	45,973	37.76	89,525	54.06	30,098	18.18	1,65,596
2004-05	55,795	28.82	96,524	49.86	41,264	21.32	1,93,583
2005-06	61,031	27.17	1,24,935	55.62	38,645	17.21	2,24,611

From the above details, it can be seen that the percentage of sale through all the three channels had remained more or less at the same level during the period 2001-02 to 2005-06.

Variety-wise sale of papers

2.28 The details of item-wise sales achieved by the Company during the five years ended 31 March 2006 are given in **Annexure-14**.

It will be seen from the Annexure that:

- The realisation from the sale of newsprint was much lower than the cost of production in 2002-03 and 2003-04 resulting in loss of Rs.9.98 crore. Availability of imported newsprint at cheaper rates affected the sales of domestic newsprint.
- The margin derived from the sale of cream wove paper, which is the predominant variety, was declining. This was due to static sales realisation compared to the increased cost of production.
- Even though the margin earned by selling copier paper produced in PM-2 was higher than that produced in PM-1, the Company discontinued copier production in PM-2 due to non-availability of size press in PM-2.

Sale to Navneet Publication India Limited

2.29 The Company entered into a contract for the supply of paper during 1 October 2004 to 30 September 2005 to Navneet Publication India Limited (NPIL). As per this agreement, NPIL committed to lift 12,000 MT of paper within this period. Based on this commitment, the Company agreed to extend a special discount of Rs.3,100 per MT (*i.e.*, the discount admissible for lifting 12,000 MT and above *per annum*). In spite of the fact that NPIL placed orders only for 9,809 MT within the contract period and the Company supplied only 6,949 MT of paper during this period, the above mentioned discount meant for the committed quantity of 12,000 MT was extended to NPIL. This resulted in undue benefit of Rs.1.10 crore to NPIL. The Company also allowed a credit period of 75 days instead of 30 days allowable as per its credit policy.

The Government stated (July 2006) that due to imposition of anti dumping duty by US for Indian paper, NPIL could not lift the agreed quantity within the contract period. The Company, therefore, extended the contract period upto 31 December 2005 to complete the quantity. The reply is not acceptable as the contract neither contained any conditions for extension of period of supply in case of inability of the buyer to lift the agreed quantity nor the purchase by the buyer for export to US was recognised as a condition in the contract. As such the applicable discount of Rs.2200 per MT only should have been given instead of Rs.3,100 per MT.

Credit policy

2.30 The declared credit policy of the Company stipulated a maximum credit period of 30 days. For payments of dues beyond this period, interest at the rate of 20 *per cent* of outstanding dues was to be charged from the date of despatch of goods till the date of payment. Audit analysis, however, revealed that the Company as a matter of routine had been allowing credit facility for periods beyond the stipulated 30 days, *viz*., up to 75 days. In addition to this, the Company had also been extending cash discounts, which were allowable for payments within the credit period of 30 days, even for the extended credit periods. For instance, Navneet Publications (75 days credit with cash discount at 1.5 *per cent)*, Manipal Group of companies, Rational Business Corporation (60 days credit with cash discount at 1.5 *per cent*) and Papyrus Printing and Packing, Nagpur (60 days credit with cash discount at 1.5 *per cent*) were extended such concessions. Further, the Company also allowed as a matter of routine incentives/discounts admissible for a particular variety of paper on fulfilling conditions (relating to lifting of committed quantity and payment of dues within the credit period) to all other varieties of paper sold and even without fulfilling the stipulated conditions.

The Government stated (July 2006) that depending on the market conditions and specific requirements of the customer, additional credit had been allowed. It was, however, observed in audit that major customers were not only given higher discounts but were also given extended credit periods beyond the normal period as stated above.

Irregular payment of discount

2.31 The Company sold paper under various schemes offering discounts. One such scheme was the note book scheme. Under this scheme, the buyer was eligible for special discount for purchase of cream wove paper of 50-64 GSM without any size restrictions. For the supply of other varieties of paper and papers of other GSM, the buyer can claim discount under the publication scheme. The Company sold 2,231 MT of paper during 1 January 2004 to 31 March 2005 and 1,787 MT of paper during 1 April 2005 to 28 February 2006 to Manipal Group of Companies which did not qualify for the grant of discount under the note book scheme and was eligible for discount only under the publication scheme. Grant of discount under the notebook scheme resulted in irregular payment of discount of Rs.1.09 crore.

The Government stated (July 2006) that eligible discount was granted considering market conditions. The reply is not acceptable as the party lifted paper which did not qualify for discount under the notebook scheme.

Acknowledgement

2.32 Audit acknowledges the co-operation and assistance extended by the staff and management of the Company and the concerned officers of the State Government at various stages of conducting the performance review.

Conclusion

The company failed to get the supply of the entire quantity of its main raw material *viz.*, bagasse, from the sugar mills with whom it had entered into required agreements, in spite of it fulfilling all its contractual obligations. This led to increase in substitution of bagasse with costlier imported pulp, which in turn, increased the cost of production of paper.

Undue benefits were extended to sugar mills through payments not covered by the terms and conditions of the contracts. The Company has not been able to reap the benefits of the modernisation of Paper Machines in full. The Company failed to achieve the budgeted pulp mix resulting in excess consumption of imported pulp. The Company also failed to achieve the budgeted norms fixed for finishing loss, retree generation, consumption of steam, chemicals and power.

Recommendations

- **The Company should incorporate suitable clauses in the barter agreements with sugar mills for supply of bagasse to safeguard its interest, particularly in the event of non/short receipt of bagasse.**
- **The Company should take adequate steps to improve the operational efficiency of paper machines so as to derive the benefit of modernisation in full.**
- **The Company should try to achieve the budgeted norms fixed by it to reduce the cost of production and to earn more revenue.**