MINISTRY OF CIVIL AVIATION

CHAPTER : II

Air India Limited

Inadequate Expenditure Control in Regional Office of Air India at New York

Highlights

Air India incurred an avoidable expenditure of US$ 1,45,553 (Rs.63.43 lakh) during the period between August 2003 and December 2004 due to delay in award of contract for security services at JFK airport and consequent increase in the rates for the services.

(Para 2.3.1)

Air India failed to secure discount/incentives amounting to US$ 68,467 (Rs.31.54 lakh) for the period from April 2002 to December 2003, which were available to it under a contract for supply of meals/food items required for its flights out from the airports at New York and Newark.

(Para 2.3.2)

Air India allowed two days lay over to its cabin attendants at New York, against the lay over of less than a day required as per the guidelines of the Civil Aviation Department of the Government of India. This resulted in avoidable expenditure of US$ 9,21,698 (Rs.4.50 crore) per annum during 2000-2002 on account of provision for accommodation for lay over for the additional day to the cabin attendants at New York.

(Para 2.3.5)

2.1 Introduction

The Air India Limited operates international flights as well as flights within India. The Headquarters of Air India is in Mumbai and the services are organised and managed through various Regional Offices located in India and abroad. The Regional Director's office of Air India at New York is the regional headquarters for Air India's USA and Canada operations. Air India operated daily flights between Mumbai and New York, Mumbai and Newark and six flights a week between Mumbai and Chicago. The Regional Director also controls a Material Management Department located at New York to facilitate the purchase/repair of spares/stores for Air India's fleet from USA/Canada.

The international airline industry was passing through a turbulent phase after the incident of 11 September 2001 and it became essential for all airlines to resort to cost cutting measures to remain in operation without incurring loss. The working of the Air India office at New York was reviewed against this background.

2.2 Scope of Audit

Air India's operations in the New York/Newark sector during the year 2002-03 were reviewed in audit to study their economy, efficiency and effectiveness. For this, Audit conducted test check, in November 2003/January 2004, of records connected with contracts relating to outsourcing of services, lay over period provided to cabin attendants and the accounting system in the Regional Office, besides the Material Management Department, at New York.

2.3 Audit Findings

The review of the operations in New York and Newark revealed that Air India incurred avoidable/extra expenditure due to lack of adequate internal controls over its outsourced activities as well as non-adoption of economy measures within the organisation as highlighted in succeeding paragraphs.

2.3.1 Avoidable expenditure/liability for security services

(a) The security services for Air India at JFK airport in New York were outsourced to outside agency M/s. Aviation Safeguards without signing any contract, effective from January 2002, despite the agency's offer in December 2001 to hold the then existing rates i.e. US$ 10.50, US$ 11.50 and US$ 14.00 for normal hours of Security Officer, Security Supervisor and Senior Security Supervisor respectively. The offered rates were valid for two years with two per cent increase for the third year if a three-year contract was awarded. There was, apparently, a delay in approval of the quoted rates by Air India Headquarters (June 2002) and the Regional Office failed to follow it up with the agency in order to have a valid contract for the rates.

In July 2003, the agency enhanced its rates to US$ 12.50, US$ 13.50 and US$ 16.00 respectively, which were higher by more than 15 per cent when compared to the rates quoted by it in December 2001. The agency informed Air India (November 2003) that it would discontinue its services from December 2003 if it were not paid at the enhanced rates. Having no alternate arrangement in place for the security services, Air India paid the enhanced rates from August 2003. Air India invited fresh tenders and the lowest rates received from the same agency were approved from December 2003. These rates were also higher than the rates approved by Air India Headquarters in June 2002 but marginally lower than the enhanced rates paid from August 2003.

The additional amount that Air India paid on account of the increase in rates worked out to US$ 25,598.42 for the period from 4 August 2003 to October 2003 and the total impact was estimated to be US$ 1,45,553 (Rs.63.43 lakh[♣]) upto December 2004 i.e. till the expiry of the three years' contract period from January 2002 to December 2004, if the contract for this period had been awarded by Air India against the agency's offer of December 2001.

The Regional Management of Air India stated (March 2004) that it had to reluctantly accept the increased rates since the agency was threatening to withdraw the services if the increase in rates was not granted. They added that it was not sure if a signed contract would have prevented the increase in rates. The contention of the Regional Management is not acceptable, as a valid contract would have created a legal obligation on the agency to stick to the agreed rates. Response of the Management of Air India Headquarters was awaited (January 2005).

(b) Documents for recording 'Time In' and 'Time Out' of personnel working under the Security Services and Ground Handling contractors were not maintained. In respect of security services provided to Air India at Newark, M/s Haynes Security Services, under a contract valid from December 2002 to November 2005, demanded payment for

---

[♣] ***@ one US$ = Rs.43.58, as of 31 December 2004*** extra hours which, as per Air India's contention, were not payable. Air India had contended that most (Haynes) employees spent less than eight hours working for Air India whereas the security agency billed at least eight hours for every one day. The only legitimate basis for determining the actual hours worked by each employee was the sign-in sheets that were signed by each employee contemporaneously at the time of arrival to work and at the time of departure. In the absence of 'Time In' and 'Time Out' records, Air India was unable to disprove the claim of the contractors and had to incur an avoidable expenditure of US$ 10,966 (Rs.5.03 lakh♦) towards out-of-court settlement reached in September 2003.

The Management stated (October 2004) that comments of the concerned department were called for and they would revert on the issue after the same were received. The Management's response was awaited (December 2004).

2.3.2 Extra expenditure in catering

Air India, Mumbai, entered into a 'Catering Cabin Service Agreement' with Flying Food Group in April 1999 for supply of all meals and other food items required for its flight out of JFK airport at New York for a period of three years upto March 2002, which was later extended to July 2002 on the same terms and conditions. In December 2002, the service was extended to cover flights introduced from Newark. The Regional office failed to secure the benefits of discounts/incentives amounting to US$ 68,467 (Rs.31.54 lakh) allowed by the contractor as per details given below:

- Prompt payment discount of two per cent in five invoices in JFK airport and two invoices in Newark, resulting in a loss of US$ 13,037 (Rs.6.19 lakh♥) during 2002-03,
- Volume discount of US$ 3,430 (Rs.1.63 lakh♥) during 2002-03 and
- Admissible additional incentives of US$ 1000 per week for the first one year operation from December 2002 in respect of Newark, leading to a cumulative amount of US$ 52,000 (Rs.23.72 lakh♠).

It was further observed that, in August 2002, the food ordered and paid for was in excess of the number of passengers by 23 per cent. Further, in one case, when cancellation of flight could not be intimated in advance, the supplier was paid US$ 4,287 billed arbitrarily for unusual pattern of 320 non-vegetarian meals, with no vegetarian meals.

The Management stated (October 2004) that prompt payment discount could not be availed of during 2002-03 as the invoices were received late and due to exigencies of work the amount could not be paid within the stipulated period of ten days. They added that a mechanism had been put in place to ensure expeditious payments in future. Regarding the volume discount and the additional incentive, the Management stated that the matter was being resolved with the contractor and in respect of the arbitrary billing for 320 meals the necessary clarification was sought from the Caterer. However, the reasons for ordering the additional meals, in excess of number of passengers, were not furnished to Audit.

♦ ***@ one US$ = Rs.45.85 as of 29 September 2003***.

♥ ***@ one US$ = Rs.47.50 as of 31 March 2003.***

♠ ***@ one US$ = Rs.45.61 as of 31 December 2003.***

2.3.3 Extra expenditure in hiring of transport

There were no negotiated and agreed terms for hiring of transport services by the Regional office at New York, other than for crew and passengers. During 2002-03, Air India hired transport on need basis from M/s Bentley Limousine Service on payment of US$ 100,304. The hire rates of car for in-town trips were US$ 35 to US$ 45 per hour plus 20 per cent gratuity, as against US$ 20 per hour paid by the India Mission in New York. Thus, there was an estimated extra expenditure of US$ 50,000 (Rs.23.75 lakh*) on this account.

The Management stated (October 2004) that the services were obtained from the same service provider considering their reliability and secured services. The Management further stated that they could get a reduction in the gratuity rate by 50 per cent in their fresh quotation received against tenders invited by them recently. Audit observed that the rates accepted by Air India were still high compared to the rates secured by the Indian Mission in New York and, therefore, it needed to explore further competitive rates in the matter.

2.3.4 Inadequate maintenance of accounts at New York

The Regional office at New York maintained only cash books in respect of six Bank Accounts operated in New York. Apart from cash books no other basic accounting records like Journals, Ledgers, Purchase/Sales books, trial balance, etc. were prepared. However, the Chief Accounts Officer at Mumbai was making the accounting entries and maintaining the complete set of accounts. It was observed that there would have been better control over expenditure and performance measurement was possible if separate accounts were maintained at the Regional Offices. The non-maintenance of accounts on double entry accounting concept had the risk of losing control over collection of sundry debts, omitting adjustment entries for non-cash transactions etc. as highlighted below.

As of 31 March 2003, an amount of US$ 3.747 million (Rs.17.80 crore♣) was outstanding under the sundry debtors account on account of traffic revenue due from agents and others. No confirmation of balances was obtained from the parties. An amount of US$ 0.375 million was considered good despite the same being outstanding for more than three years.

An amount of US$ 0.347 million was shown as outstanding from various Station Managers. These were mainly debit notes, which needed to be paired off against credits due to these stations. This had not been done.

The Regional office showed an amount of US$ one lakh as dues from its Transport Service Contracts that provided air transportation to parties in exchange for supplies made/services rendered. The amount represented only the value of transport utilised by the parties. This resulted in overstatement of Sundry Debtors and understatement of expenditure and thus the non-passing of journal/adjustment entries for non-cash transaction had a bearing on the corporate accounts.

The Management stated (October 2004) that they proposed to introduce Double Entry Accounting Concept at each station to enable them prepare their own trial balance. The debts shown against station managers were several years old and write-off action was

---

* ***@ one US$ = Rs.47.50 as of 31 March 2003***

♣ ***@ one US$ = Rs.47.50 as of 31 March 2003.***

awaiting approval from sanctioning authority. Regarding the adjustment entries in respect of Transportation Service Contracts, the Management confirmed that all the pending adjustment entries had since been made on the basis of the Audit observation. The fact remains that proper maintenance of accounts was essential to ensure correctness of accounts, prompt action to realise debts and confirmation of balances from the parties concerned. The ongoing deliberations on the proposed implementation of Double Entry Concept at each station may only minimize the existing weakness in the system.

2.3.5 Additional lay over for crew at New York and consequential expenditure

According to the orders issued by the Civil Aviation Department of the Government of India in August 1997, where the flight time of cabin attendant in international sector was less than 11 hours, a pro rata rest period of twice the flight time shall be provided at base. The flight operated by Air India to New York had cabin attendants boarding from London and the flight time was 6 hours and 35 minutes. The cabin attendants were provided lay over for 48 hours, which was much in excess of the prescribed period. Air India incurred an expenditure of US$ 921,698 (Rs.4.50 crore[♦]) per annum during 2000-2002 on account of provision of accommodation for lay over for additional day to cabin attendants at New York, which was avoidable. The Regional Management stated in March 2003 that in terms of 'record note of understanding in March 1995' it was agreed by the Management to give two days' lay over as against the earlier practice of giving one day in this sector.

The Corporate Management stated in October 2004 that they would endeavour to take up the issue with the Association during the wage negotiations. The fact remains that the Management did not do so, in order to reduce the expenditure as per international practice, though the Civil Aviation Department had issued the order way back in August 1997.

2.3.6 Non-accounting of Passenger Service Orders

The Regional office received blank copies of Passenger Service Orders (PSOs) from Air India's Mumbai office. These were machine numbered documents used for authorising entitled passengers to use hotel and transport services from the designated hotel/agency. There was no control record to indicate the receipt, distribution and utilisation of these documents and to ensure that these documents were not misused.

The Management acknowledged (October 2004) the necessity of the control record and confirmed that the system had since been strengthened.

2.3.7 Continuation of Material Management Department (MMD) in New York

MMD, New York was set up in 1964 to facilitate purchase of spares/stores from USA and Canada for Air India. Indian Airlines Limited had also been availing of its services till January 2000 when the services were discontinued, considering the improved communication facilities. During 2002-2003, out of 20682 Purchase Orders placed by Mumbai on suppliers in USA and Canada, orders based on quotations received by MMD were only 1567, representing 7.04 per cent of the total orders. The Regional Office made payments for the supplies. MMD did not have a databank of the vendors and had no practice of negotiating rates. The role of MMD in facilitating purchases was evidently not significant. Since follow up of the orders could be done at Mumbai due to the faster

---

[♦] ***@ one US$ = Rs.48.80 as on 28 March 2002.***

and cheaper means of communication and preference to electronic orders by the suppliers in USA/Canada, the necessity of continuing MMD in New York needed review.

The Management stated (October 2004) that they had already downsized the employees' strength of MMD at New York and argued that continuation of the office at New York was necessary to sustain the operations and to provide support to Engineering and other related departments. The Management added that the office had the responsibility of correlating receipts and authorising payments for over 20000 invoices per annum. It was, however, observed that, in November 1999, Indian Airlines Limited had decided to follow the centralised purchase from India considering the improved communication facilities and the consequent saving of about Rs.80 lakh to Rs.90 lakh per annum. Therefore, a cost-benefit analysis needs to be carried out to justify the continuation of MMD.

2.4 Conclusions

The expenditure of aggregating to US$ 11,96,684 (Rs.5.74 crore) was avoidable in respect of outsourced services for security, transport and catering as well as the excessive lay over period. This included the extra expenditure of US$ 9,71,698 (Rs.4.74 crore), in respect of hiring of transport services at uncompetitive rates and the excessive lay over period to cabin attendant, which was of recurring nature annually. Non-maintenance of adequate accounts at the Regional Office led to uncontrolled accumulation of debtors and the risk of omitting non-cash transactions.

2.5 Recommendations

- Adequate control mechanism should be put in place in order to obtain competitive rates and ensure verification of the bills of the contractors for outsourced services for security, transport and catering.
- The excessive lay over period should be reduced without delay.
- Adequate accounting system should be introduced to ensure proper accounting of all cash & non-cash transactions and control over the outstanding dues.
- Cost-benefit analysis of MMD should be carried out to justify its continuation, keeping in view the faster and cheaper communication facilities presently available world-over.

The review was issued to the Ministry in February 2005; its reply was awaited (March 2005).