1. Introduction

1.1 The process of disinvestment of Public Sector Undertakings (PSU) had been started by the Government in 1991-92. Different methodologies for disinvestment were adopted from time to time such as the auction method[1] or partial disinvestment in favour of mutual funds and financial institutions in the public sector, strategic sale[2] for privatization between 1999-2000 and 2002-2003 and market sale[3], either through initial public offer[4] or offer for sale[5] for divestment of minority shareholding during 2003-05.

1.2 It was in August 1996 that Government established a Disinvestment Commission (DC) initially for a duration of three years to advise it on all aspects relating to public sector disinvestment. The main terms of reference were

- to draw a comprehensive overall long-term disinvestment programme within 5-10 years for the PSUs referred to it by the Core Group comprising Secretaries of selected Ministries;
- to determine the extent of disinvestment in each PSU;
- to prioritise the PSUs referred to it by the Core Group in terms of the overall disinvestment programme;
- to recommend the preferred mode(s) of disinvestment for each of the identified PSUs;
- to supervise the overall sale process and take decisions on instrument, pricing, timing etc., as appropriate;
- to select the financial advisors for specified PSUs to facilitate the disinvestment process; and
- to monitor the progress of disinvestment process and take necessary measures and to advise Government on possible capital restructuring of the enterprises by marginal investments, if required, so as to ensure enhanced realization through disinvestment.

---

[1] ***Auction*** *is one of the methods for divesting shares under market sale where the pricing is optimised through bidding. It is less time consuming and involves low transaction cost. It is targeted at the institutional investors. In the initial rounds of disinvestment, Government divested its stake in PSUs thorough this method.*

[2] ***Strategic sale*** *implies selling of a substantial block of government holdings to a single party, which would not only acquire substantial equity holdings of up to 51 per cent but also bring in the necessary technology for making the public sector enterprise viable and competitive in the global market. Alternatively, Strategic Sale includes two elements, one is transfer of block of shares to a Strategic Partner and the second is transfer of management control to the Strategic Partner.*

[3] ***Market sale*** *signifies sale of shares to individuals, financial institutions or private sector business, which can then be traded in the market. It includes the sale of shares through initial public offer, offer for sale to public, international offering, private placement and auction*

[4] ***Initial Public offering (IPO)*** *is the first issue of equity shares to the public by an unlisted company.*

[5] ***Offer for sale*** *is offer of shares by existing shareholder(s) of a company to the public for subscription, through an offer document.*

1.3 The Disinvestment Commission made recommendations with respect to 58 out of 72 PSUs were referred to it. The recommendations were for strategic sale in respect of 36 PSUs, which involved transfer of management, for offer of part of equity in 6 PSUs and closure/ sale of assets in respect of 4 PSUs. No disinvestment was recommended in the remaining 12 PSUs.

1.4 The Commission was an advisory body and the final decision on the recommendations would vest with Government. The Commission was reconstituted in July 2001 after the expiry of the term of the first DC in 1999, submitted reports on 41 PSUs including four review cases and was wound up in October 2004.

1.5 Government classified (March 1999) the PSUs into those functioning in strategic and non-strategic areas for the purpose of disinvestment. All PSUs except those in the three areas of arms and ammunition and allied items of defence equipment, defence air-craft and warships, atomic energy (except in the areas related to the generation of nuclear power and application of radiation and radio-isotopes to agriculture, medicine and non-strategic industries) and railway transport were to be considered non-strategic. In these non-strategic cases it was decided that the reduction of Government stake to 26 *per cent* would not be automatic and the manner and pace of doing so would be worked out on a case by case basis.

1.6 Government further decided (March 1999) that divesting their stake to less than 51 *per cent* or to 26 *per cent* would be taken on considerations as to whether the industrial sector required the presence of the public sector as a countervailing force to prevent concentration of power in private hands, and whether the industrial sector required a proper regulatory mechanism to protect the consumer interests before the PSUs were privatised. Government also decided to strengthen strategic PSUs, privatise non-strategic PSUs through gradual disinvestment or strategic sale and devise viable rehabilitation strategies for the weak units.

1.7 In December 1999 Government established a new Department for Disinvestment (DOD) to lay down a systematic policy approach to disinvestment and privatisation and to give a fresh impetus to this programme. In the budget speech of 2000-01, Government stated that it was prepared to reduce its stake in the non-strategic PSUs even below 26 *per cent*, if necessary and that there would be increasing emphasis on strategic sales. It further stated that it would set up a Disinvestment Proceeds Fund and the entire proceeds from disinvestment would be used for meeting the expenditure in the social sector, restructuring of PSUs and retiring public debt.

1.8 Government disinvested its stake in **nine** PSUs, namely, Modern Food Industries Limited **(MFIL)**, Bharat Aluminium Company Limited **(BALCO)**, Hindustan Teleprinter Limited **(HTL)**, Computer Maintenance Corporation Limited **(CMC)**, Hindustan Zinc Limited **(HZL)**, Videsh Sanchar Nigam Limited **(VSNL)**, Indo Burma Petroleum Limited **(IBP)**, Indian Petrochemicals

Corporation Limited **(IPCL)** and Paradeep Phosphates Limited **(PPL)** between 1999-2000 and 2002-2003 through the strategic sale route in which block of shares, as indicated in the Table 3, along with the management control were passed on to a strategic partner except in the case of **IBP** where the control had passed on to another PSU, namely the Indian Oil Corporation Limited (IOC). This report examines the disinvestment of these nine PSUs in accordance with the audit objectives spelt out in paragraph **2** below. However, in addition to these cases, Government disinvested its stake in two small PSUs, namely Lagan Jute Manufacturing Company Limited **(LJMC)** and Jessop & Company Limited **(JCL)** besides 19 properties of Indian Tourism Development Corporation **(ITDC)** and three hotel properties of Hotel Corporation of India **(HCI)** during 1999-2000 and 2003-04.

1.9 Coming to the subsequent developments, the National Common Minimum Programme of May 2004, inter alia, stated that **Navaratna**[6] PSUs were to be retained in the public sector and privatisation was to be considered on a case by case basis. Generally, profit-making PSUs were not to be privatized. While every effort was to be made to modernize and restructure sick PSUs and revive sick industry, chronically loss-making undertakings were to be either sold-off, or closed after all the workers had got their legitimate dues and compensation.

1.10 Government in the budget speech 2004-2005 stated that it would establish a Board for Reconstruction of Public Sector Enterprises (BRPSE) to advise Government on measures to be taken to restructure the PSUs, including cases where disinvestment or closure or sale was justified. BRPSE was to examine only cases of loss-making/potentially sick PSUs referred to or taken up suo-moto by it and make recommendations on disinvestment to Government. BRPSE was established on 6 December 2004**.**

1.11 Objectives and Progress of Disinvestment

1.11.1 The primary objectives of disinvestment of the PSUs as indicated in the manual of policy and procedure issued by DOD in April 2001 were the following:

- releasing large amount of public resources locked up in non-strategic PSUs, for redeployment in areas that were much higher on social priority, such as, basic health, family welfare, primary education, social and essential infrastructure;
- stemming further outflow of scarce public resources for sustaining the unviable non-strategic PSUs;
- reducing the public debt that was threatening to assume unmanageable proportions;

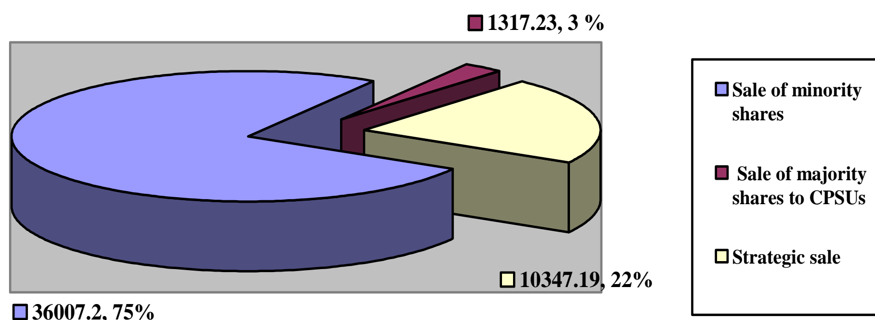
---

[6]***Navratna PSUs-*** *Government granted substantial enhanced autonomy to selected 11 PSUs. The criteria for selecting the enterprises included size, performance, nature of activity, future prospects and the potential to develop as world level players.*

- transferring the commercial risk, to which the taxpayers' money locked up in the public sector was exposed, to the private sector wherever the private sector was willing and able to step in; and
- releasing other tangible and intangible resources, such as, large manpower currently locked up in managing the PSUs, and their time and energy, for redeployment in high priority social sectors that were short of such resources.

1.11.2 Government realized disinvestment proceeds of Rs. 47,671.62 crore during 1991-2005, which included Rs. 36,007.20 crore from the sale of minority shares in 43 PSUs during this period and Rs. 1317.23 crore during 2000-2001 from the sale of majority shares of Kochi Refineries Limited (KRL), Chennai Petroleum Corporation Limited (CPCL) and Bongaigaon Refineries and Petrochemicals Limited (BRPL) to sister PSUs. Subsequently, Government adopted the strategic sale route for disinvesting equity in the PSUs during the period from 1999-2004. Government privatised 11 PSUs and 22 hotel properties of HCI and ITDC through the strategic sale route and realized Rs.10,347.19 crore. Of the total proceeds of Rs. 36,007.20 crore, Government realized Rs. 15,205.35 crore and Rs. 2700.06 crore during 2003-04 and 2004-05 respectively by divesting minority shareholding through the market sale route, either through Initial Public Offer or Offer for Sale. Diagram 1 gives a pictorial presentation.

Diagram 1: Government receipts from disinvestment between 1991-92 and 2004-05



1.11.3 The Ministry of Finance reported that the total receipts from disinvestment through strategic sales during the period 1999-2000 and 2003-04 amounted to Rs.10,347.19 crore. This amount actually included only Rs. 6359.07 crore attributable to disinvestment of Government equity. Details of the remaining amount of Rs. 3988.12 crore have been shown in Table 1.

Table 1: Details of other receipts relating to disinvestment

(Rs. in crore)

Sl. No.	Name of PSU	Nature of receipt	Year	Amount realized
1.	Bharat Aluminum Co. Ltd.	Pre disinvestment restructuring receipts	1999-2000	275.42
2.	Computer Maintenance Corporation	Employees Stock option Scheme	2002-2003	6.07
3.	Hotel Corporation of India Ltd.	Receipts realized by Air India, the holding company in respect of sale of three hotel properties	2001-2003	242.51
4.	Videsh Sanchar Nigam Ltd.	(i) Pre disinvestment restructuring receipts	2001-2002	2249.75
		(ii) Employees Stock Option Scheme	2001-2002	25.19
5.	State Trading Corporation of India Ltd.	Special dividend	2001-2002	40.00
6.	Minerals and Metals Trading Corporation of India Ltd.	Special dividend	2001-2002	60.00
7.	Hindustan Zinc Ltd.	Employees Stock Option Scheme	2002-2003	6.19
8.	Indian Petro Chemicals Corporation Ltd.	Employees Stock Option Scheme	2003-2004	64.81
9.	Maruti Udyog Ltd.	Renunciation of rights issue of 12,16,341 shares against Rs.1000 crore control premium.	2002-2003	1000.00
10.	Jessop and Co. Ltd.	Receipts realised by Bharat Bhari Udyog Nigam Limited (BBUNL), the holding company	2003-2004	18.18
	Total amount realized			**3988.12**

1.11.4 Government actually received Rs. 5544.42 crore from strategic sale of nine PSUs covered in this report over the period 1999-2000 to 2002-03, which also included an amount of Rs. 1153.68 crore realized from Indian Oil Corporation (**IOC**) from the disinvestment of **IBP**. Details of the receipts through strategic sale in respect of nine PSUs covered in this report are indicated in Table 2.

Table 2 : Details of the receipts through strategic sale in respect of nine PSUs

(Rs. in crore)

Sl.No.	Name of PSU	Year	Amount realized
1.	Modern Food Industries Ltd.	1999-2000	105.45
2.	Bharat Aluminum Co. Ltd.	2000-2001	551.50
3.	Hindustan Teleprinter Ltd.	2001-2002	55.00
4.	Computer Maintenance Corporation	2001-2002	152.00
5.	Indo Burma Petroleum Company Ltd.	2001-2002	1153.68
6.	Videsh Sanchar Nigam Ltd.	2001-2002	1439.25
7.	Paradeep Phosphates Ltd.	2001-2002	151.70
8.	Hindustan Zinc Ltd.	2002-2003	445.00
9.	Indian Petro Chemicals Corporation Ltd.	2002-2003	1490.84
	Total amount realised		**5544.42**

1.11.5 In addition, Government realised Rs. 367.95 crore from the exercise of put option[7] and call option[8] in respect of **MFIL** and **HZL** under the Shareholders Agreement (SHA) during 2002-03 and 2003-04 respectively. Government also disinvested **LJMC** and 19 hotel properties of **ITDC** and realized Rs. 446.70 crore during the period 2000-2003.

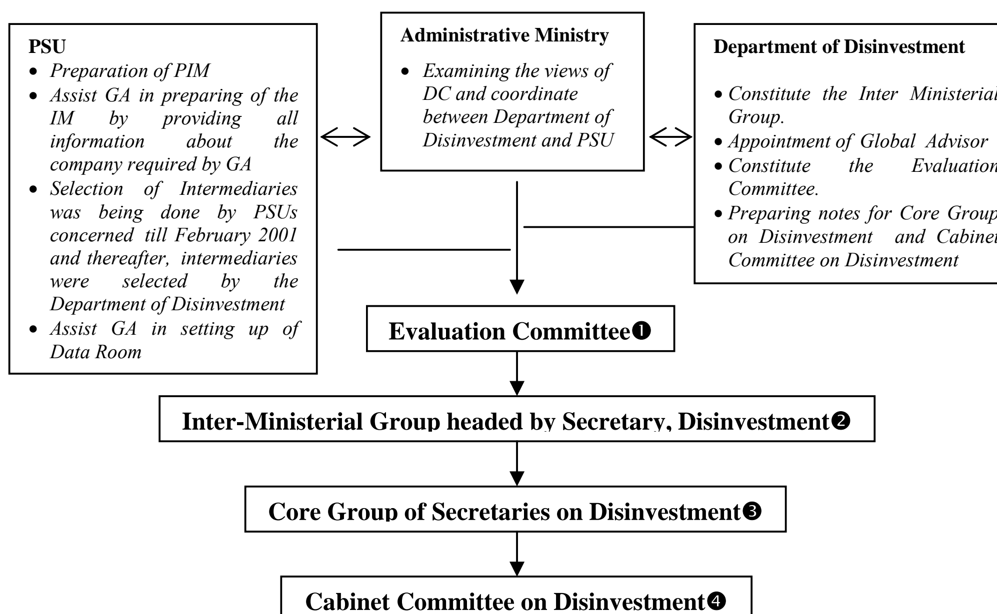
1.11.6 The total receipts of Rs. 10,347.19 crore represented an average contribution or realization of Rs. 2586.80 crore per year during the period of four years (1999-2000 to 2002-03) and constituted 1.84 *per cent* of the average net accrual accretion of internal debt (Rs. 1,40,248.25 crore) for the same period of four years ending 31 March 2003. Similarly, these receipts amounted to 6.75 *per cent* of the average annual expenditure of Rs. 38,298 crore incurred by Government on social sector schemes for the above mentioned four year period. In view of the fact that the receipts were not kept in any separate or distinct account these funds became fungible with the other receipts in the Consolidated Fund of India, making it difficult to assess the end use of the funds.

1.11.7 Audit noted that Government could achieve targeted receipts on account of disinvestment projected in the budget statements during 1991-92, 1994-95, 1998-99 and 2003-04. However, the actual receipts for the period 1999-2000 to 2002-03 when disinvestment was carried out mainly through strategic sale, could not reach the budgeted target. The actual receipts worked out to 18.60 *per cent*, 18.71 *per cent*, 47.15 *per cent* and 27.90 *per cent* of the respective targets during 1999-2000, 2000-01, 2001-02 and 2002-03.

[7] ***Put option** is an option to sell an asset at a specified price on or before a specified date*
[8] ***Call option** is an option to buy an asset at a specified price on or before a specified date*

1.12 The process of Disinvestment

1.12.1 Prior to the setting up of a separate Department of Disinvestment (DOD) in 1999, the disinvestment of Government equity in selected PSUs was carried out by the Department of Public Enterprises (DPE) in association with the concerned PSUs and their Administrative Ministries/ Department, the Ministry of Finance and the Cabinet Secretariat. Other Central Government Ministries/ Departments were co-opted on the basis of the requirement of a particular transaction The department was given the status of Ministry of Disinvestment in September 2001. Subsequently, in May 2004, it was converted from an independent Ministry to the Department of Disinvestment (DOD) under the Ministry of Finance. DOD was responsible for taking each proposal to the Cabinet Committee on Disinvestment (CCD), the highest decision making body in the approval channel as indicated in the Diagram 2 below. Government decided (June 2004) to assign the responsibility for taking decisions relating to disinvestment to the Cabinet Committee on Economic Affairs (CCEA).



❶ An Evaluation Committee (EC) comprised the Additional Secretary and Financial Advisor of the Administrative Ministry, Joint Secretaries of select ministries including the concerned administrative Ministry.

❷ The Inter-Ministerial Group (IMG) was the third tier where inter-ministerial consultation took place at the primary level and was chaired by the Secretary, Department of Disinvestment and comprised officers of the of select ministries including the concerned administrative Ministry, the Chairman and Managing Director and the Director (Finance) of the PSU concerned.

❸ The Core Group of Secretaries (CGD) the second highest tier in the decision making process, was headed by the Cabinet Secretary and comprised Secretaries of select ministries including the administrative Ministry and Planning Commission.

❹ The Cabinet Committee on Disinvestment (CCD), the highest decision making committee headed by the Prime Minister was formed in February 1999, and comprised Ministers from various departments including the Minister concerned with the PSU under disinvestment.

1.12.2 Advisors and Intermediaries

The Department of Disinvestment (DOD) was to be assisted by various Advisors and Intermediaries in the management of disinvestment. These included an overall Advisor known as the Global Advisor (GA) or Financial Advisor, legal advisors and asset valuer. In addition, Environmental Consultants, Mining Experts, Chartered Accountants, Accounting Adviser and Public Relations firms were also appointed for disinvestment of PSUs depending on requirement.

1.12.3 Global Advisor (GA)

GA was to assist the DOD and Government in all aspects of disinvestment transactions whose responsibilities, inter-alia, covered suggesting measures to enhance the sale value, preparing a detailed information memorandum, marketing the offer, inviting and evaluating the bids, assisting during negotiations with prospective buyers, drawing up the sale and other agreements and advising on post-sale matters. Advisors were to be appointed through an open competitive bidding procedure after inviting Expression of Interest[9] (EoI) from them to submit their proposals. They were to make a presentation before the Inter Ministerial Group (IMG). The Ministry of Disinvestment was to adopt criteria depending on their strategic sale experience, sector expertise and experience, local presence and the understanding of the PSU, as approved by the Core Group for short listing them. The fees payable to GAs were generally of two types, namely ***success fee*** which was a fixed percentage of the gross proceeds to be received by Government from the disinvestment and ***drop dead fee*** which was a lump sum amount payable to GA only in the event of the transaction being called off by Government.

1.12.4 Legal Advisor

Legal advisors were appointed on contractual basis to look into the legal issues and help the Department of Disinvestment (DOD) in drafting and finalising various agreements. They were responsible for ensuring compliance with legal requirements and that there were no defects in title to properties. They advised DOD on issues related to material contracts, loan and lease agreements, title deeds and insurance cover**.**

1.12.5 Asset Valuer

The asset valuation was conducted by an asset valuer, normally selected by an inter-departmental committee, comprising representatives of the Department of Disinvestment and the administrative Ministry and the Chairman and Managing Director of the PSU from a panel recommended by GA. The Asset Valuer was

---

[9] ***Expression of Interest*** *containing background information about management, ownership structure, business activities including joint ventures, legal capacity of the company/consortium, participating in a privatization transaction, was to be submitted by the interested party at the prescribed address by the stated deadline. It was to be normally submitted along with a statement of legal capacity and a litigation impact statement.*

paid a lump sum amount as fees. While assessing the fair value of the property, the valuer was to take into consideration the status of the title of the company over the land and buildings, any restrictive covenants incorporated in the title documents imposing limitations on the use or transfer of the property, values at which transactions had taken place in the recent past for properties of comparable nature. The valuer was also to conduct valuation of plant and machinery, mines as well as intangibles, if required.

1.12.6 A process flow chart depicting the various stages of a typical disinvestment transaction through the strategic sale route is indicated at **Annex-I**.

1.13 Formulation of guidelines for disinvestment of PSUs

The Ministry formulated guidelines for valuation of PSUs (May 2001) and for the qualification of advisors as well as bidders (July 2001). The disinvestment of MFIL and BALCO was completed before the issue of these guidelines though the process outlined therein was generally followed.

1.13.1 Guidelines for valuation of PSUs

The Disinvestment Commission had, inter-alia, emphasised that valuation of the PSU proposed for disinvestment should be independent, transparent and free from bias and had suggested that three methods of valuation, namely the 'Discounted cash flow' (DCF), 'Relative valuation' approach and 'Net asset value' approach could be adopted. The Ministry of Disinvestment issued the guidelines in May 2001 according to which four methodologies, namely **Discounted Cash Flow (DCF) Method, Transaction Multiple Method, Balance Sheet Method** and **Asset Valuation Method** were to be used for valuation of the PSU to be disinvested. The methodologies are outlined in **Annex II**. While the first three are business valuation methodologies generally used for valuation of a going concern[10], the last methodology is generally considered for valuation of assets especially in case of liquidation[11] of a business though it also indicates the replacement cost of the assets of the business. In the case of listed companies, the market value of shares during the last six months could also be used as an additional indicator, for valuation of the companies.

1.13.2 Guidelines for qualification of advisors

The Ministry prescribed additional criteria (July 2001) for the qualification of advisors and prospective strategic partners. These provided for disqualification on account of any conviction by a court of law or indictment or adverse order by a regulatory body relating to a grave offence and matters relating to security and integrity of the country. The advisors were also required to furnish an undertaking to the effect that there was no conflict of interest as on the date of their appointment as advisors in handling the transaction and that, in future, if

---

[10] ***Going concern*** *envisages continuance of operation of the business by infusion of superior technical and managerial skills besides additional capital.*

[11] ***Liquidation*** *would involve selling all assets of an enterprise instead of selling it as a going concern.*

such a conflict of interest arose, they would immediately inform Government of the same.

1.13.3 The share purchase and shareholders agreements[12] were two vital documents in the process of strategic sale, which were also called transaction documents[13]. The shareholders agreement (SHA) was to set out the conditionalities agreed between Government and the strategic partner (SP) regarding how the affairs of the company would be managed after the disinvestment. Similarly, the share purchase agreement[14] (SPA) was to describe the shares being sold, the purchase price and several representations and warranties and covenants of SP and Government such as post closing adjustments in the case of unlisted PSUs. It was imperative that the Ministry carefully balanced the competing interests of all stakeholders in drafting these agreements and specifically ensured that no undue concessions or benefits were conferred on SP, especially by default or through ambiguities in the agreements.

2. Scope of Audit and Audit Objectives

2.1 Scope of Audit

2.1.1 Major transactions relating to disinvestment of Government shareholding during the period 1999-2000 to 2002-2003 in nine PSUs, namely, Modern Food Industries Limited **(MFIL)**, Bharat Aluminium Company Limited **(BALCO)**, Hindustan Teleprinter Limited **(HTL)**, Computer Maintenance Corporation **(CMC)**, Indo Burma Petroleum Company Limited **(IBP)**, Videsh Sanchar Nigam Limited **(VSNL)**, Paradeep Phosphate Limited **(PPL)**, Hindustan Zinc Limited **(HZL)**, and Indian Petrochemicals Corporation Limited **(IPCL)** were examined and the results are presented in this report. The records pertaining to post closing adjustment in the case of unlisted disinvested PSUs (**MFIL, BALCO, PPL,** and **HTL)** could not be examined as the cases were not finally decided by Government till May 2006. A profile of the PSUs divested through the strategic sale route examined in audit and covered in this report is given in **Annex-III.**

2.1.2 Disinvestment of the identified stake in each of the nine PSUs took nearly four years to be completed. The strategic sale process was used for the first time

[12] ***Shareholders Agreement (SHA)*** *defines the rights and obligations of both the parties; it reflects the protection of employee's rights, business plans, indemnification clauses etc. SHA is entered into among the President of India (acting through the Joint Secretary of the administrative Ministry), the company and the strategic partner.*

[13] ***Transaction document*** *consist of Shareholders Agreement (SHA), Share Purchase Agreement (SPA) and Guarantee Agreement.*

[14] ***Share Purchase Agreement (SPA)*** *describes the purchase price, mode of payment and the actions at closing time. It also lays down representations and warrantees given by both the parties. SPA was to be entered into among the President of India (acting through Joint Secretary of Administration Ministry), the company and the strategic partner (SP).*

by Government in these cases that involved considerable preparatory work and complex valuation exercises. Outcome of the process of disinvestment did not follow immediately after the sale of the identified stake. Issues arising out of the implementation of the share purchase agreement and share holders agreement were not resolved even several years after the completion of the process of disinvestment. It was thus necessary to allow adequate time to elapse before subjecting the process of disinvestment to an audit scrutiny so that audit could cover all significant issues and frame practical recommendations for further improvement of the process of disinvestment.

2.1.3 Inspection reports were issued on each case of disinvestment of nine PSUs followed by a draft consolidated report to the Ministry. Findings included in the draft report issued in February 2006 were discussed in an exit conference with the Ministry in April 2006. Reply received from the Ministry in May 2006 has been taken into account while preparing this report.

2.2 Audit objectives

2.2.1 The Audit examination essentially had the following objectives:

- To examine whether the procedure for disinvestment was well defined with reference to the objectives of disinvestment;
- To verify the extent of achievement of the objectives of disinvestment as laid down in the guidelines on disinvestment of the Ministry;
- To assess the consistency of application of the prescribed procedures including the valuation methodologies adopted for sale;
- To seek assurance that the procedure of disinvestment had generated adequate competitive tension so as to obtain the best value; and
- To examine the efficiency of the management of the process of disinvestment, especially in adequately protecting Government's interests before, during and after the disinvestment.

3. Audit Findings

Before discussing the audit findings in detail, it would be relevant to note the essential details of the immediate outcome of the process of disinvestment followed in respect of nine PSUs examined in this report. The final bid price exceeded the reserve price in seven out of nine PSUs disinvested. While the reserve price was not fixed in MFIL, the final bid price was less than the reserve price in PPL. These results would need to be viewed in the light of the audit findings described in the following paragraphs. Table 3 gives a bird's eye view of disinvestment of Government shareholding in the nine PSUs.

Table 3: Details of status of disinvestment of nine PSUs

(Rs. in crore)

Sl. No.	Name of PSU	Percentage of equity divested	Reserve price	Final bid price accepted	Name of Strategic Partner
1.	MFIL	74	Not fixed	105.45	Hindustan Lever Limited
2.	BALCO	51	514.4	551.50	Sterlite
3.	HTL	74	38.80	55.00	Himachal Futuristics Limited
4.	CMC	51	108.88	152	Tata Sons Limited
5.	IBP	33.59	377	1153.68	Indian Oil Corporation
6.	VSNL	25	1218.37	1439.25	Panatone Finvest Limited
7.	PPL	74	176.09	151.70	Zuari Maroc Phosphates Limited
8.	IPCL	26	845	1490.84	Reliance Petroinvestment Limited
9.	HZL	26	353.17	445	Sterlite Opportunities and Ventures Limited

3.1 Difficulty in assessment of achievement of objectives of disinvestment.

3.1.1 Audit examination revealed that the procedure for disinvestment through the strategic sale route was generally well defined and laid down in the manual of policy and procedure issued by DOD in April 2001 followed by guidelines on valuation in May 2001. The procedure was essentially based on the experience of DOD gathered from the sale of Government stakes in **MFIL** and **BALCO** that were completed before April 2001. The approval process involved a multi tier mechanism comprising groups of experienced officials commencing from IMG and going up through CGD to CCD which was the final decision taking authority. An Evaluation Committee (EC) was also separately formed for the purpose of making initial recommendation on the reserve price for each PSU under disinvestment after taking into account the presentation of the Global Advisor (GA). These groups or committees had the benefit of the assistance and reports of expert advisors and other intermediaries who were to be appointed through a transparent mechanism and also had access to the legal and other relevant technical advice required for the purpose.

3.1.2 Audit noted that while the broad objectives of the overall disinvestment programme were laid down, individual sale objectives were not clearly spelt out prior to taking up the individual sale transaction. The nine PSUs examined in this report comprised listed, unlisted, loss making as well as profit making PSUs spread across various sectors, and clear individual objectives would have enabled a comprehensive assessment of the extent of their achievement.

3.1.3 Creation and operation of the Disinvestment Proceeds Fund by transferring the sale proceeds to the fund as initially intended in the policy statement of Government in 2000-01 would have enabled transparent and effective deployment of the resources mobilized for the intended purposes. This would have, in turn, enabled a reasonable assessment of the outcome of each disinvestment with reference to its contribution to the achievement of the primary objectives of disinvestment. In the absence of such a mechanism and no other

clear evaluating tool at its command, the Ministry of Disinvestment was not in a position to assess the extent to which the resources mobilized were actually utilized for meeting the expenditure on social sector or for restructuring the PSUs or for retiring public debt.

3.2 Preparatory work needed better and more effective coordination

3.2.1 Audit examination revealed that **BALCO, VSNL, PPL** and **IPCL** did not have clear titles to all the real estate, land and buildings in their possession as noticed from the records produced and examined. Unless the titles to the land were clear, it would not have been possible for the value of such land to have been accounted for in the business valuation of the PSU for fixing the reserve price properly. One of the reasons for not valuing these properties properly was that neither the PSU nor the administrative Ministry nor DOD had made adequate efforts to ensure that clear title deeds were in their possession or to remove encumbrances on the land and buildings before taking up disinvestment. Consequently, the asset valuers had either discounted or not considered the value of such properties.

3.2.2 The Ministry of Finance in their reply (May 2006) stated that they were not required to issue any instructions/guidelines to the entities to be divested to keep their records/ documents in proper shape. As part of their normal functioning, the PSU concerned was expected to maintain all the requisite documents without being directed either by the administrative Ministry or the Department of Disinvestment (DOD). The Ministry while accepting the validity of the issue raised by Audit added that the Department of Public Enterprises would be requested to take up this matter and to issue suitable instructions to all administrative ministries/ PSUs to update the position regarding title deeds as well as encumbrances on land and buildings owned by PSUs. It is to be noted that the Ministry of Disinvestment was established precisely to ensure efficient coordination amongst all concerned agencies including the administrative Ministry and the PSU concerned and for this purpose had all the assistance of expert advisors at its command. The reply of the Ministry only underlined the absence of the good practice of fulfilling the basic requirement of ensuring clear titles to the land and buildings in respect of PSUs already identified and slated for disinvestment. The Department of Disinvestment intimated Audit (July 2006) that the Department of Public Enterprises had issued necessary instructions on 30 June 2006 to all administrative ministries.

3.2.3 Relaxation of conditions of disinvestment after issue of Expression of Interest (EoI).

Audit examination also revealed that crucial decisions having substantial financial implication were taken after inviting EoI from prospective bidders in the case of **VSNL, PPL** and **IPCL.**

3.2.3.1 VSNL: EoI for selection of the strategic partner (SP) was called on 19 February 2001 and financial bids for acquiring 25 *per cent* stake in VSNL were received on 1 February 2002. Initially, one of the conditions was that the

prospective SP should furnish Earnest Money Deposit (EMD) of Rs. 500 crore in cash along with the financial bid. Though IMG did not agree (May 2001) to the request of the bidders for the conversion of EMD into bank guarantee of a lesser amount, IMG modified (November 2001) the EMD from Rs. 500 crore in cash to Rs. 250 crore in the form of irrevocable bank guarantee. Audit examination revealed that the amount of bank guarantee was sought to be further reduced to Rs. 100 crore in the note of the Ministry to CCD (02 February 2002). Similarly the decision to indemnify the SP to the extent of 25 *per cent* of the total tax liability subject to a maximum of Rs. 150 crore payable by the disinvested PSU, if certain deductions claimed by the latter under section 80(IA) of the Income Tax Act were not finally allowed, was taken only on 17 January 2002. The Ministry of Finance stated (May 2006) that both these decisions had been taken prior to the date of receipt of financial bids on 01 February 2002 and the date of the valuation report of GA. These decisions were thereafter approved by Government (5 February 2002) after the disinvestment on 02 February 2002. While procedurally the decisions were not irregular, resolution of the issues before calling for Expressions of Interest (EoI) would have imparted greater clarity to the matter for the prospective bidders and instilled transparency into the process besides putting in place a good practice.

3.2.3.2 The most favoured customer status awarded at the fag end of the time limit for receipt of financial bids

The Ministry of Disinvestment became aware that if a clarification to the effect that the two sister PSUs namely, BSNL and MTNL were directed to route their international calls through VSNL at least for some length of time after disinvestment, it would enhance the attractiveness of the offer. The Ministry of Disinvestment took up the proposal for the same with CCD on 23 December 2001 though the EoIs for selection of SP were invited on 19 February 2001. The decision conferring the most favoured customer status to VSNL by MTNL and BSNL for routing the International Long Distance (ILD) calls by the latter PSUs through VSNL at market rates for a period of two years after transfer of management control to the strategic partner (SP) was communicated by the Department of Telecommunication (DoT) to VSNL on 29 January 2002, two days before receipt of financial bids. The Ministry of Finance in its reply in May 2006 did not explain the delay in taking up the proposal much earlier and why it had to wait till 29 January 2002 to clarify the issue to the bidders though the expert GA was in place on 05 March 2001 and could have alerted the Ministry suitably.

3.2.3.3 Withdrawal of contingent liability of Rs. 1402.80 crore

There was a major contingent liability of Rs. 1402.80 crore as the Income Tax Department had disallowed deduction of licence fees paid by VSNL since 1995-96 and retrospectively for 1993-94 and 1994-95 whereas VSNL claimed it as deductible expenditure under Sec 37 of the Income Tax Act. The Income Tax Appellate Tribunal passed an order in favour of VSNL against which the Income Tax Department filed an appeal in the High Court. The initial proposal for

disinvestment of VSNL was approved by Government on 01 February 2001 but it took the Ministry till 26 December 2001 to obtain the decision of Government to the effect that the advice of the Ministry of Law on the issue would be binding on both VSNL and the Department of Revenue. Ultimately, the Department of Revenue agreed on 30 January 2002 to withdraw the case pending before the High Court. The Ministry of Disinvestment intimated the same to the bidders through GA on 31 January 2002 even as the financial bids were to be opened on 1 February 2002 at 4 PM. Had the process of withdrawal of contingent liability been decided by the Ministry earlier after more effective coordination with all concerned and the decision communicated to the bidders well before submission of bids, a better assurance would have been provided that the bidders had taken into account the effect of such withdrawal before submitting their bid, especially as the amount involved was almost equal to the value for which VSNL was ultimately sold to the strategic partner (SP). This decision had the potential of attracting more bidders and could also perhaps have prevented some withdrawals from the bidding process. The Ministry of Finance in their reply (May 2006) stated that VSNL was a listed company. The contingent liability, including its quantum and the nature was disclosed in the annual accounts of the company. The prospective bidders were also aware of this fact. They, however, stated that the audit observation that such issues should be settled prior to invitation of EoIs would be kept in view in future disinvestments. The Ministry's reply that the bidders were aware of the contingent liability misses the facts that the amount involved and the decision to withdraw the same were significant enough to have made the acquisition more attractive with the attendant prospects of higher bids being offered.

3.2.3.4 Delay in demerging identified surplus land

The Department of Telecommunications (DOT) informed the Ministry on 21 January 2002, (10 days before the receipt of financial bids) that 773.13 acres of land had been declared surplus out of 1230.13 acres of total land belonging to VSNL. The surplus land was to be demerged in favour of a resulting company, which was to have a shareholding pattern identical to VSNL as on the date of demerger. The Ministry asked the asset valuer not to value the surplus land and hence the value of surplus land remained out of the valuation exercise undertaken by the Ministry of Disinvestment.

Audit noted that the Ministry of Disinvestment had not specified any time limit for completion of the demerger plan in the Shareholders Agreement (SHA) and the actual demerger had not taken place till May 2006 after disinvestment of the PSU in February 2002. As a result, the surplus land was still in the custody of the disinvested company in which SP had management control and could acquire majority shareholding.

Regarding the transfer of surplus land of VSNL, the Department of Disinvestment (DOD) intimated (June 2005) Audit that DoT was actively pursuing the issue. Further, in response to audit queries, on 30 September 2005, DOD stated that on 17 January 2005, the strategic partner (SP) had incorporated a

private realty company with an authorized capital of Rs. 25 lakh and paid up capital[15] of Rs. 5 lakh and all the three Directors were to be private persons. The draft scheme of arrangement and demerger prepared by SP was stated to be under examination from the legal angle in DOT, which had also constituted a committee to expedite the process of demerger of surplus land of VSNL. The Ministry of Finance in their reply in May 2006 stated that this was a post disinvestment issue and was being handled by the Ministry of Communications and Information Technology. The Ministry also stated that the call option[16] restricted SP from calling all the shares held by Government who shall have at least one share in VSNL and that the affirmative right of Government on matters such as sale of land survived as long as Government remained a shareholder.

The Ministry's reply was not convincing. SP had the option to purchase the remaining shares (except one voting equity share) of Government at a predetermined fair value, after February 2006 and Government was obliged to allow it. SP could also sell the surplus land in the case of demerger not taking place and was required to pay only 25 *per cent* of the benefit accruing from such sale to Government according to the shareholders agreement. As Government had retained 26 *per cent* shareholding in VSNL after disinvestment, Government was entitled to a share in the sale proceeds of surplus land in proportion to the percentage of further sale of equity to SP. Government could at best have blocked the proposal of SP to dispose of the surplus land which, in effect, would have meant only locking up the value in land depriving Government of any benefit out of the land to be demerged. Further, the shareholding pattern of the resultant realty company was to be the same as on the date of demerger. With more time taken for demerger the SP had the opportunity to increase its shareholding through secondary market. Thus, the delay in finalising the arrangement had the potential of conferring unquantifiable benefit from the sale of surplus land on SP in proportion to its shareholding acquired from secondary market on the date of demerger. More than four years have passed since the disinvestment and Government had not been able to derive any benefit from the surplus land of the PSU. Incidentally Audit noticed that in the case of disinvestment of **IBP**, the subsidiary (Balmer Lawrie and Company Ltd.) was demerged prior to the disinvestment of IBP, a good practice that could have been followed in VSNL too.

3.2.3.5 PPL: Government's decision of a limited financial restructuring of the PSU by converting preferential shares of Rs. 117.65 crore and loan of Rs. 85 crore into equity was taken on 16 January 2002 which was 10 months after calling of Expression of Interest (EoI) in March 2001 and 23 days before inviting the financial bids. Expeditious decisions on significant issues such as financial restructuring of PSUs and their prompt implementation are good practices that

[15] ***Paid-up capital*** *is capital credited as paid up.*
[16] ***Call Option*** *is an option to buy an asset at a specified price on or before a specified date.*

would have only helped in making the process of disinvestment more robust and successful. The Ministry of Finance in their reply (May 2006) stated that finalization of financial restructuring schemes of sick PSUs was, in practice, a time-consuming process, requiring inter-ministerial consultations and approval of competent authorities. However, they agreed that the suggestion of Audit to settle such issues prior to invitation of EoIs would be kept in view in future.

3.2.3.6 IPCL: The profitability and attractiveness of the PSU were dependent on some crucial issues such as the continued availability and the cost of feedstock, which was being purchased from other PSUs, namely ONGC and GAIL. In addition, there were certain unresolved issues relating to deferred taxation (Rs. 750 crore) and other contingent liabilities (Rs. 168 crore), settlement of which before the calling for EoIs would have enabled generation of increased competition. The PSU had taken up the issues of continued availability and the cost of feedstock, deferred taxation and contingent liability with the administrative Ministry in July 1998 before the decision of disinvestment was taken in December 1998. The short listed bidders had also sought clarifications on the issues in September/ October 1999. GA had also admitted (April 2002) in their valuation report that the liability of Rs. 750 crore on account of deferred taxation and Rs. 168 crore relating to contingent liability would affect the valuation. Audit noted that the agreement for supply of feedstock by ONGC/GAIL was finally drawn in May 2002 whereas the bidders submitted the financial bids on 29 April 2002. The issues of deferred taxation and contingent liability were not settled unlike in the case of VSNL where a contingent liability of Rs. 1402.80 crore was settled, though belatedly, through the intervention of the Ministry, as mentioned in paragraph **3.2.3.3**.

3.2.3.7 Government approved (16 December 1998) the sale of 25 *per cent* of government equity in IPCL. Subsequently, Government decided (18 November 2000) to transfer the Vadodara Plant, one of the three plants owned by IPCL to the Indian Oil Corporation (IOC) on the basis of a proposal initially mooted by IOC. But later on Government reversed its decision and decided (13 November 2001) that the equity offered for strategic sale in the first lot be raised to 26 instead of 25 *per cent* as initially proposed by DOD with the commitment of further disinvestment of at least 25 *per cent* equity. The Ministry of Finance in their reply (May 2006) stated that initially, Government had decided to disinvest 25 *per cent* in IPCL through strategic sale. Thereafter, IOC had pointed out that IPCL's Vadodara plant was adjacent to IOC refineries and was meant to be an outlet for Naphtha produced in the refinery. In view of the synergy of operations and the interests of IOC and IPCL, the Vadodara plant of IPCL was decided to be transferred to IOC after proper valuation of assets and only the remaining two units of IPCL (at Nagothane in Rajgarh and at Gandhar in Bharuch) were to be disinvested. The Group of Ministers (GoM) deliberated on the view of the Ministry of Petroleum and Natural Gas that it was very important for IOC to take over all the three units of IPCL in order to ensure downward integration and the former's long term sustenance. It was considered that the sale of IPCL to IOC would send a negative signal from the view point of Government policy on

reforms. This was also considered to deny Government the advantage of competitive bidding. As IOC was also not into the petro-chemicals sector and did not have expertise in this sector, it was felt that there would be no advantage that would accrue to IOC by earmarking the transfer of IPCL to IOC. Objections were stated to have been received on behalf of small investors who felt that they would not benefit from the merger, as there would be no open-offer obligation on IOC. After considering all the above factors, Government decided (November 2001) to proceed with the strategic sale of 26 *per cent* equity in IPCL without separating the Vadodara plant. Government also decided to issue fresh advertisement for disinvestment of 26 *per cent* equity in IPCL.

3.2.3.8 The decision on crucial aspects of the disinvestment of IPCL that were raised by the administrative Ministry could not be taken for over three years. The uncertainty that had thus prevailed in this disinvestment did not help infuse clarity of intent and purpose into the process of disinvestment which was not a good practice conducive to the achievement of one of the primary objectives of disinvestment, namely obtaining the best value for the stake on sale. There should also be clarity on whether the stake in PSU ought or ought not to be sold to another PSU as allowing it may not be in line with the spirit of disinvestment and disallowing the same might not generate adequate competition for effective price discovery.

Recommendation

- *The Ministry may ensure through improved and effective coordination with the administrative Ministries and the PSUs identified for disinvestment that the titles to all properties are in place and their valuation is carried out properly on the basis of their market value. This would enable Government to obtain correct valuation in their independent exercise undertaken through the Global Advisor and the asset valuer.*
- *The Ministry may also ensure that decisions on extinguishments of liabilities and other major pending issues are expedited well before the calling of EoIs. This would enable the interested and qualified parties to take into account correct and deserved valuation while submitting their bids.*

3.3 Appointment of Global Advisor (GA) and other intermediaries

3.3.1 Opening of financial bids

GA was the most important technical expert in the process of disinvestment as the business valuation worked out by it formed the basis for arriving at the reserve price in all nine PSUs examined. GA also played an important role in selection of other intermediaries and was instrumental in effectively marketing the sale of these PSUs. The process of selection of GA would have to be transparent, fair and objective. The guidelines of the Ministry also recognized this fact and had standardized the evaluation criteria and weightages to be assigned to each for determining the technical competence of the prospective Global Advisors (GA), as decided by CGD on 1 April 1999. Audit noted that the selection of advisors was done through open bidding process in all the cases and

the selection committee, (IMG) evaluated the bidders on the basis of the identified criteria and weights in all cases. An average of the scores given by the members of the IMG on each criterion was arrived at and thereafter a weighted average score for each bidder was calculated. However, no threshold score or benchmark score was prescribed for short listing the bidders based on technical qualification before opening their financial bids. As a result, financial bids of only a few bidders ranging between one and three (as decided by IMG in each case) out of those who made presentations before IMG were finally opened as indicated in Table 4.

Table 4: Details of bidding process for selection of Global Advisor

Sl.No.	Name of PSU	Number of EoIs received	Number of parties qualified to make presentation	Number of financial bids opened
1	MFIL	9	9	3
2	BALCO	8	7	2
3	HTL	6	5	1
4	CMC	16	13	3
5	IBP	12	12	2
6	VSNL	16	12	2
7	PPL	6	2	2
8	IPCL	9	9	3
9	HZL	14	11	3

Audit noted that in the case of **HTL,** IMG decided (14 June 1999) to open only one financial bid on the ground that the bidder securing the highest marks was best suited to perform the duties of GA. IMG recommended this bidder considering that the fees quoted by them was at par with the fees of GA appointed for disinvestment of MFIL. It was also recommended that any further negotiation for reducing the fees might result in compromise in quality and engagement of only low paid employees by GA for the work. The Ministry of Disinvestment in their reply (August 2003) stated that there were well defined criteria for selection of GA. Since the difference in marks obtained between the first and second ranked bidders was 7.2 *per cent* (64.2 minus 57 out of total marks of 100), IMG recommended that the bidder obtaining the highest score only should be invited for negotiation. The Ministry's decision to invite a single bidder for negotiation and not having further negotiation on the plea that any possible reduction in fees would mean sacrificing the quality of work was not a good practice. It would also imply that the Ministry was, in the process, deprived of the best possible choice for a significant exercise including valuation which included rendering assistance in enhancing the value of the stake under disinvestment.

3.3.2 The Ministry of Finance in their reply (May 2006) stated that CGD in its meeting held on 16 July1999, had decided that the process of selection of Global Advisors (GA) should be in two stages wherein, after the initial short listing of the merchant bankers on merit, price offer received from the first two or three parties should be considered before arriving at a conclusion on the final selection.

The recommendation to shortlist two or three bidders by IMG was in line with the above decision of CGD. Government approved (4 July 2001) a proposal designed to reduce subjectivity and obtain more competitive financial offers, according to which an Inter-Ministerial Selection Committee (an IMG to be constituted by the DOD for this purpose) would set a qualification mark depending on the requirements of the transaction and the number of candidates available. The financial offers of all the firms achieving the qualifying marks would be opened and the bidder with the lowest financial bid among them would be awarded the assignment.

3.3.2.1 Audit noted that Global Advisors for all the nine transactions of disinvestment covered in this report were appointed by 6 March 2001, for which there was no apriori threshold score or benchmark prescribed for shortlisting the bidders, though the Ministry subsequently decided (July 2001) to adopt a more transparent procedure.

3.3.3 Standardization of bid formats

No formats were prescribed standardizing the requirements of financial bids for selection of GA and assessing the success fees and drop dead fees. This rendered the comparison of fees quoted by various bidders difficult. Audit noted that in the case of **HTL,** bidders were asked to resubmit their bids in view of the difficulty in comparison. The Ministry of Finance in their reply (May 2006) stated that IMG in its meeting held on 4 June 1999 and 7 June 1999 decided that the bidder that had secured the highest score on the basis of presentation made was to be considered as the best suited for performing the duties of GA, and decided that such a bidder was to be called for negotiations. IMG in its meeting held on 14 June 1999 asked only one bidder to reconsider its financial bid. While negotiating, the bidder was not informed that they had been considered the best among five bidders. Audit noted that the Ministry's reply was contrary to the view expressed by IMG on 14 June 1999 to the effect that in view of different structuring of the financial bids submitted, it was difficult to quantify and establish the lowest bidder. Standardized bid formats would have helped in achieving better comparison of bids, which was a good practice that could have been followed usefully.

3.3.4 Global Advisors' fees

The success fees ranged between 0.19 *per cent* and 1.25 *per cent* of the gross proceeds in the cases of disinvestment examined in this report. There was no instance of payment of drop dead fee in any of the nine cases. The subject of cost of each disinvestment transaction or cost of sale has been commented upon in paragraph **3.11** of this report.

3.3.5 Advisory Service Agreements with GA were delayed

Audit examination revealed that though DOD had issued a mandate or appointment letter to the GAs after their selection, the formal agreement between the Ministry and the GAs was signed after considerable delay, sometimes even

after approval of sale transaction by Government as indicated in Table 5. In the case of **PPL,** the agreement was not signed at all.

Table 5: Details of Finalisation of Agreements with GAs

Sl. No.	Name of PSU	Date of issue of appointment letter to GA	Date of signing the agreement with GA	Date of approval of sale transaction by CCD	Time taken to sign the agreement with GA
1	MFIL	7 July 1998	20 October 1998	25 January 2000	3 months
2	BALCO	9 July 1999	14 June 2000	27 February 2001	11 months
3	HTL	13 September 1999	27 September 2001	5 October 2001	2 years
4	CMC	6 March 2001	16 October 2001	5 October 2001	7 months
5	IBP	11 December 2000	31 January 2002	2 February 2002	2 years and 1 month
6	VSNL	5 March 2001	1 February 2002*	5 February 2002	11 months
7	PPL	1 March 2001	No agreement signed	14 February 2002	Not applicable as no agreement was signed.
8	IPCL	16 April 1999	16 May 2002	18 May 2002	3 years and 1 month
9	HZL	13 November 2000	9 January 2002	27 March 2002	2 years and 2 months

**Final agreement was signed with the Consortium on 20 May 2002.*

Audit noted that as per Government orders, no work should be commenced without proper execution of agreement. It was only in exceptional circumstances and in no other case should work of any kind have been allowed to commence without prior execution of contract documents. However, in a majority of the cases of disinvestment though the letter for appointment was issued to GA after their selection, the agreement was drawn when the process of disinvestment was likely to be completed or sometimes even after the completion of the sale process. The GA was thus left contractually unbound for the entire period, which was not a good practice and did not provide assurance of professional handling of an important aspect of the process of disinvestment. The Ministry of Finance in their reply (May 2006) stated that finalization of the agreement with GA was a time-consuming process. In some cases, the provisions of the agreement also required reconsideration keeping in view the sensitivities of the advisors, requirements of the transaction, besides vetting by the Department of Legal Affairs. However, in future, efforts would be made to enter into these agreements with advisors, as soon as practicable. The Ministry may, incidentally note that the practice adopted was violative of Government orders and was also otherwise not a good management practice.

3.3.6 Modification in the extent of disinvestment was not taken advantage of.

In the case of **MFIL, HTL** and **IPCL,** the extent of disinvestment was increased after the appointment of GA. However, suitable advantage of these changes were not taken by achieving corresponding reduction in the percentage of success fees of GA though the success fees was directly linked to the quantum of the sale proceeds. The Ministry of Finance in their reply (May 2006) stated that in the

case of **MFIL**, by the time the decision to increase the level of disinvestment to 74 *per cent* was taken by Government, GA had already spent five months on the assignment. In the case of **HTL,** Audit noted that CGD had decided to appoint GA in the meeting held on 4 September 1999, i.e. almost six months before Government's decision to raise the equity to be divested was taken. The Ministry stated that the process of appointment of GA took about four months and by that time the decision to increase the level of disinvestment to 74 *per cent* was taken by Government, GA had already spent about eight months on the assignment. Similarly, in the case of **IPCL**, GA was appointed on 16 April 1999 whereas the decision to increase the disinvestment in IPCL from 25 to 26 *per cent* was taken on 13 November 2001. By this time, GA had already spent over two years on the assignment. It further stated that it would not have been practical to appoint another GA or to call for a fresh financial bid where GA had already spent considerable time on the assignment.

3.3.6.1 Had the agreement with GA been entered into promptly and had it contained a suitable clause to allow Government the flexibility to take appropriate advantage of the increase in the quantity of stake decided during the process of disinvestment it would have been possible to achieve some reduction in the fees paid to GA in such cases. Simultaneously, Government could also have considered allowing corresponding benefit to GA in cases of any reduction in the quantity of stake sold or any other decision that would have adversely impacted the business valuation adopted during the process of disinvestment. This would have, incidentally, strengthened good practices in the process.

3.3.7 Appointment of Intermediaries

According to the instructions issued by the Ministry of Finance in August 1999 for the appointment of intermediaries, the concerned PSUs were to appoint them following their own procedure and pay their fees, which was later reimbursed by the Ministry of Disinvestment. On 4 July 2001, Government approved a proposal of the Ministry of Disinvestment whereby the intermediaries were also to be appointed by the Ministry of Disinvestment itself from the list provided by GA by following the same procedure that was adopted for the selection of GA. Audit noted that except for **CMC, VSNL,** and **PPL,** in other cases the PSU being divested had appointed the intermediaries. In the case of **CMC** both the asset valuer and the legal advisor were appointed by the Ministry of Disinvestment before the procedure for appointment was approved by Government.

3.3.8 Appointment of Asset Valuer

The asset valuers were appointed from the panel recommended by GA but the criteria for short listing them were not determined or specified. Audit examination also revealed that adequate time was generally not allowed to the asset valuers. Some instances are given below.

3.3.8.1 BALCO: The valuer was given only 19 days to value fixed assets, which in the view of the asset valuer required at least 45 days. As a result, asset valuation had inadequate documentary basis and adequacy of the valuation of

civil works and plant and machinery was not verifiable in audit. The Ministry of Finance in their reply (May 2006) accepted that the time available to the asset valuer was rather limited and as a result the valuer had obtained replacement cost through verbal enquiry instead of obtaining the price by sending written enquiries to the manufacturer or supplier concerned.

3.3.8.2 CMC: The Ministry had neither prescribed any time-frame for completion of this job nor mentioned the authority to whom the valuation report and the claims were to be submitted and clarified these details only on an enquiry by the valuer. The Ministry of Finance in their reply (May 2006) stated that the valuer was informed vide the letter of appointment that he had to work in close coordination with GA who was aware of the progress of the transaction and ensured that the work of asset valuer was completed as close as possible to the date of valuation by GA.

3.3.8.3 VSNL: Appointment of the asset valuer was done without conducting negotiations making it open-ended and at the highest quote. The Ministry of Finance did not explain any reason in their reply to Audit in May 2006.

3.3.8.4 Audit could not verify / comment on the procedure adopted for the appointment of asset valuer, legal advisor, chartered accountant and environmental consultant in the case of disinvestment of **IBP** and **IPCL** as the records relating to their selection and appointment were not made available by the Ministry of Disinvestment.

3.3.8.5 The Ministry of Finance in their reply (May 2006) stated that generally, a time of six weeks was given for asset valuation. The asset valuer was also informed vide the letter of appointment that he had to work in close coordination with GA who was separately advised to keep the details of the matter confidential. This was stated to be essential to ensure that the asset valuer's report was ready as close as possible to the date of valuation of the PSU so that the data remained relevant. Hence, a time limit for submission of the report could not have been given in advance.

Recommendation

The Ministry may define the scope of work of the Global Advisors and standardize the mandate of and the agreement with them so that the latter do not have an open ended and disparate arrangement for what is an extremely sensitive and important exercise intended to aid the process of disinvestment and obtain the maximum value for the stake under disinvestment. The asset valuers would need to be given adequate time to prevent the exercise from becoming redundant.

3.4 Valuation

Valuation is a central issue in any disinvestment, particularly in the case of a strategic sale. The Ministry prescribed four methodologies of valuation in the guidelines for valuation issued in May 2001 to be used by GA, as briefly mentioned in paragraph **1.13.1** above.

3.4.1 Discounted Cash Flow (DCF) Methodology

This methodology expressed the present value of a business from its projected future earning capacity. Future cash flows were worked out on the basis of past performance and projections which, in turn, were to be based upon assumptions in the areas affecting production, sales, taxation, working capital, capital and revenue expenditure and were discounted at an appropriate discount factor (also called the Weighted Average Cost of Capital (WACC)[17]). The discount factor (WACC) was a function of the debt equity ratio, cost of debt and cost of equity[18]. Assumption of a higher cost of debt and equity would have increased the magnitude of the discount factor leading to depressed enterprise value[19] and vice versa. A flow diagram for calculation of discounted cash value has been indicated at **Annex IV.**

Audit examination of the valuation exercise carried out by GAs in the nine PSUs disinvested revealed the following.

3.4.1.1 Absence of business plans[20]

Business plan which contains the future projections and strategy of the PSU was an important document that would have enabled a comparison between the projections of the PSU and GA while examining the appropriateness of business valuation. This document was not available for examination in audit in respect of **VSNL, HZL** and **IPCL.**

The Ministry of Finance in their reply (May 2006) stated that in the case of VSNL, other than the National Long Distance (NLD) business plan, no other business plan was provided to GA by the PSU while HZL was not in a position to provide detailed business plan for the next three to five years and GA made assumptions regarding the future financial performance. Audit noted that GA had disclosed in the valuation report that valuation assumptions were not validated by HZL, which seriously hindered the reliability of the valuation. The Ministry further stated that the business plan of IPCL had been called for and copy thereof would be provided to Audit when received from GA.

---

[17] ***Weighted Average Cost of Capital (WACC)*** *is the discount rate applied to estimate the present value of explicit forecast period free cash flows as also continuing value. The principal elements of WACC are cost of equity, the post-tax cost of debt and the target capital structure of the company (a function of debt to equity ratio).* ***WACC=*** *(Debt/Total Capital)*(After-Tax Cost of Debt)+(Equity/Total Capital)*(Cost of Equity)*

[18] ***Cost of equity*** *is the desired rate of return for an equity investor given the risk profile of the company and associated cash flows. Cost of equity = Risk free rate + (equity risk premium x β), where β (beta) of a company reflects the underlying risk of a business over and above the stock market risk.*

[19] ***Enterprise Value*** *is the market value of equity plus debt or total market asset value of the company.*

[20] ***Business plan*** *is a document prepared by the management of a company showing the future projections about the business of the company, keeping in view the economic scenario, future capital investments and the growth potential of the company.*

The availability of a fundamental document like the business plan of the PSUs under disinvestment and a clear record of the reasons for the variation in the projections contained in the business plan and those adopted by GA would have provided an added assurance of the completeness and adequacy of the process followed for determining the enterprise valuation and ultimately the reserve price

3.4.1.2 Audit examination also revealed some instances of improper or far too conservative assumptions having been adopted by GA while arriving at business valuation under the DCF methodology. There were no recorded reasons in the Ministry justifying the assumption made by GA though these had an impact on the business valuation based upon which the reserve price was to be fixed for the stake under disinvestment. Following were the specific instances.

MFIL: Audit noted that despite the fact that franchisee operations of the PSU could register significant growth, backed by superior marketing and managerial skills of the strategic partner, income of Rs. 3.2 crore on this account had been ignored in GA's projections. DOD in their reply (March 2001) stated that income from franchisee operations was taken as 'nil' on the basis of the management's feedback to GA. The reply was not tenable as the output of 24 franchisees with a bread manufacturing capacity of 5,54,000 Standard Loaves (SL) per day could not have been simply ignored in any prudent valuation. Audit could not verify the management feedback as it was not found on record.

BALCO: The installed capacity for finished products of BALCO had increased to 131,400 MT with the commissioning of a Cold Rolling Mill in 2000-2001. GA however, did not take into account the increase in the capacity of finished products, kept the production pegged at the earlier level of 91,000 MT to 93,000 MT and completely ignored the capacity addition in the pipeline.

The Ministry of Finance in their reply (May 2006) stated that detailed discussion with management and understanding of market trends convinced GA that the new cold rolling mill had been sanctioned because of the obsolescence of the old rolling mill. This obsolescence had led to poor quality of products in comparison to the trends of market demand. GA assumed full capacity of the new cold rolling mill (over a time) and maintained production of old rolling mill at 50 *per cent* of rated capacity without scaling it down. Had the company outsourced primary metal and tried to increase capacity utilization of the old rolling mill, the market would not have fully absorbed the poor quality material and margins would have declined. The Ministry's contention was not acceptable as BALCO's old rolling mill was working at more than 100 *per cent* capacity utilization till at least 2000-01, the product was being sold in the market and this facility could not have been considered to become outdated as soon as the new mill was commissioned.

CMC: GA's projections for revenues were on the lower side and those for expenses were higher than those stated in the PSU's business plan but the reasons for the difference were not disclosed in the valuation report. The difference had the effect of depressing the business valuation of the PSU. On being pointed out in audit, the Ministry of Disinvestment in their reply (November 2003) stated that

there was no basis for the business plan of the PSU, and the projections were adopted by GA based on their discussions and consequent agreement with the management. This was an instance of inadequate or improper documentation of the basis of an important aspect of valuation exercise, which was not a good practice.

IBP: GA had not assumed the figures of sales and margin as per the business plan of the PSU. While projecting sales, GA had reduced the figure by 16 *per cent* in 2002 compared to 2001 and reduced the same by another 5 *per cent* in 2003, though there was no instance of reduction in the sales in the past. This ultimately reduced the sales figures for the forecast period to nearly half of the projection depicted in the business plan for 2010 as evident from Table 6 given below:

Table 6: Variation in projections of Global Advisor and the business plan-IBP

(Rs. in crore)

	Actual				Forecast								
Item	**1998**	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**
Income from sale as per Business Plan (BP)	4690	5670	6819	8076	8565	9615	11294	12997	14968	17261	19622	22247	25138
% increase/ reduction		21	20	18	6	12	17	15	15	15	14	13	13
Income from sale as per GA			6810	8388	7031	6653	7294	8000	8775	9630	10568	11598	12731
% increase/ reduction				23	(-)16	(-)5	10	10	10	10	10	10	10

The Ministry of Finance in their reply (May 2006) stated that for the period 2005 to 2010, GA had adopted the sales at a lower figure based on their discussions with the management of the PSU. It was also pointed out that from 2002 onwards, while the Oil Marketing Companies (OMC) component of sale had boosted the sales figures these did not have a commensurate impact on profitability which were therefore reduced to zero in the DCF model as it was assumed that no OMC sales would be possible post privatization. The Ministry of Disinvestment did not ensure that GA kept a detailed record of the explanation for the adoption of lower figures of sales along with the exact nature of the discussion with the management of the PSU that was stated to have taken place.

Audit further noted that GA had also made a provision of Rs. 33 crore towards environmental compliance without explaining the basis of the provision. The Ministry of Finance in their reply (May 2006) stated that expenditure of Rs. 33 crore on environmental compliance was due to non-compliance on various counts by the Retail Petroleum Outlets (RPOs) and Oil Storage Facilities (OSFs) on account of a number of environment related statutes. Not only was the reply of the Ministry general in nature but it also did not indicate the exact nature of non-compliance and the basis of computation of the amount of expenditure.

PPL: Audit noted discrepancies in the production figures of various products projected by GA and those indicated in the annexure to GA's valuation report. The Ministry of Finance in their reply (May 2006) stated that GA had explained the difference in the figures as an inadvertent typographical error. GA was understood to have further explained that the correct figures from their main report had been considered in the computation of business value. Apparently, the details of the valuation report were not checked in the Ministry.

IPCL: GA had projected the sales growth on the lower side compared to the actual performance and had provided the consolidated figure of expenditure without any details while deriving net cash flow in respect of consumption of raw material, employees' remuneration and benefits, manufacturing, administration and selling expenses, interest and depreciation. GA had also deducted an amount of Rs. 4275.75 crore indicating the figure as net debt without providing any details**.** As a result, Audit could not examine the basis of these projections.

GA had adopted the Weighted Average Cost of Capital (WACC) as 13.8 *per cent*. However, while deriving the Free Cash Flow, GA adopted WACC at 15 *per cent*. Adoption of a higher WACC rate had the impact of depressing the business valuation of the PSU. No reasons for adopting higher value of WACC were found on record.

Audit further noted that GA did not value the joint ventures of the PSU though IPCL had a 37 *per cent* stake in Gujarat Chemical Port Terminal Company Limited, which operated the liquid chemical handling port at Dahej that was commissioned in 2000 that enabled IPCL to handle export consignments and access feedstock. The PSU also had an investment of Rs. 25 crore in GE Plastic India Ltd, which remained to be valued.

The Ministry of Finance in their reply (May 2006) stated that comments of GA had been called for and reply was awaited. This only underscored the absence of records in support of the valuation by GA in the Ministry, which was not a good practice.

HZL: Audit examination revealed that though GA's projection period covered 2002 to 2023, the projection for revenues, expenses and costs for the explicit forecast period[21] 2006 to 2022 was not indicated by GA in the valuation report. Moreover, GA's projection of sale of Lead and other products were unverifiable as the basis of projections of the quantity sold in respect of such products for the explicit forecast period were not explained in the report. Normative tax rate of 35.7 *per cent* assumed in the first round of bidding in November 2001 was later increased to 36.8 *per cent* in the second round of bidding in March 2002 without furnishing any reasons, though the tax rate had not changed in 2001-02. Adoption of higher tax rate without any justification had the effect of depressing the enterprise value.

---

[21] ***Explicit forecast period*** *is a period of time (5 to 10 years) for which the net present value of the free cash flows arising from the business is projected under the DCF method.*

The Ministry of Finance in their reply in May 2006 stated that in respect of projections of sale of Lead and other products, attempts were made to obtain the comments of GA who had ceased operations in 2002. GA did not have any employees now and were not in a position to offer comments on any of the mandates undertaken by them or the basis for various calculations, valuation and analysis done for arriving at financial evaluation while undertaking the HZL mandate.

Audit noted that the Ministry had again not kept any record of the assumptions behind the valuation exercise carried out by GA though these affected the business valuation.

3.4.1.3 Inconsistency in computation of equity value

The enterprise value of a PSU is worked out by discounting the value of free cash flow[22] arrived at under DCF methodology by applying WACC as the discount rate. The equity value is worked out thereafter by deducting the net value of debt of the PSU from the enterprise value. As per the formula used for calculating the discount rate indicated in the foot note 17, if the cost of debt is not taken into account, the discount rate becomes higher than the case where the cost of debt is taken into account.

Audit examination revealed that the GA concerned had, while valuing **MFIL, BALCO, CMC, HTL,** and **PPL** which were not zero debt PSUs, taken into account cost of debt while estimating WACC. The net value of debt as on the valuation date was correctly deducted from the enterprise value so as to arrive at the equity value of the PSU concerned. In the case of **IPCL**, the basis for the deduction of net value of debt by GA was not ascertainable from the records produced. Audit further noted that in the case of **IBP** and **VSNL,** both zero debt companies as on the date of valuation, GA concerned did not take into account the cost of debt while estimating WACC and also did not deduct any value of debt while working out the equity value from the enterprise value.

Audit examination of the valuation of **HZL** under DCF methodology, however, revealed that though the PSU had debt on the date of valuation, GA had not taken any cost of debt while working out WACC. In addition, GA had deducted the amount of net debt of Rs. 38.2 crore from the enterprise value before deriving the equity value. The practice of deducting debt from the enterprise value without adopting cost of debt in estimating WACC was inappropriate.

The Ministry of Finance in their reply (May 2006) stated that GA had assumed the target debt to equity ratio at zero percent for estimating future cash flow as the level of HZL's debt had been historically very low. However, while deriving the equity value, GA deducted Rs. 38.2 crore from the enterprise or firm value, being the net debt outstanding as on 31 December 2001. The Ministry's reply

---

[22] ***Free cash flow (FCF)*** *for a year is derived by deducting the total of annual tax outflow inclusive of tax shield enjoyed on account of debt service, incremental amount invested in working capital and capital expenditure from the respective year's profit before depreciation interest and tax (PBDIT) for the explicit period.*

was not convincing as the amount of net debt deducted by GA from the enterprise value worked out to almost 9 *per cent* of the paid up equity capital of the PSU and could not be considered very low. The action of GA resulted in adoption of a higher WACC, which did not take into account the cost of debt and ended up depressing the enterprise value. The equity value was also depressed as GA had deducted the amount of net debt equivalent of Rs. 38.2 crore from the already depressed enterprise value.

Audit examination thus revealed deviations and variations between assumptions of different GAs and the projections made by the PSUs in their business plans wherever these were available and there were no documented records in support of the deviations. Consequently, the reasonability and the validity of assumptions could not be fully assured and the Ministry ended up furnishing replies essentially defending the action of GAs while assuring that the omissions would be rectified or avoided in future and that the minutes of consultation between the management and GA would be recorded in future cases of disinvestment. Issue of standard guidelines to GAs and maintenance of detailed record of the assumptions and justification in support of the treatment of crucial items in the projections adopted by GA would have helped in achieving increased levels of transparency that the procedure of disinvestment deserved.

3.4.2 Asset Valuation Methodology

The asset valuation methodology estimated the cost of replicating the tangible assets of the business at market value. Alternatively, this methodology could also disclose the amount which could be realized by liquidating the business by selling all tangible assets of a business and paying off the liabilities. GA was required to make an adjustment on account of net current assets, voluntary retirement schemes (VRS) and capital gains tax in the asset value derived by the asset valuer. It was to provide a good indicator of the value which could be realized if the business were to be liquidated or even if the business was to be replicated. It was significant because most of the PSUs slated for disinvestment had large chunks of unutilized or under utilized land and buildings, plant and machinery whose value might not have got captured efficiently in other methods. Some of these assets might not be considered essential for the running of the business, also called non core or surplus assets and hence might not have figured in the valuation of the business by the potential buyers. Nonetheless, these non-core assets ought to have fetched good value to Government. Audit examination of the asset valuation methodology adopted in nine disinvested PSUs revealed the following.

3.4.2.1 IBP: The PSU had appointed six asset valuers for valuation of the assets located at different regions. While three asset valuers furnished the value of the assets as on 31 December 2000, one had furnished the value as on 1 March 2001 and the remaining two valuers had furnished the same as on 31 March 2001. It was also noticed that four valuers had not mentioned the rationale for the selection of the sample depots, retail outlets and filling stations in their valuation reports. The Ministry stated that sampling was done due to practical difficulties and in consultation with the PSU which had provided the list of fixed assets to the

valuer containing full details of all assets which had been audited by the statutory auditor who had certified that there were no major discrepancies between book records and physical records. It would have facilitated the process of correctly assessing the asset value of the PSU if the valuation was done as on the same date and the method of sample selection was mentioned in the reports.

3.4.2.2 VSNL: The valuer had mentioned in the valuation report that they had suffered from limitation of scope due to non-receipt of certain important information from DOD. The Fixed Asset Register (FAR) was incomplete as it did not have details of individual assets and various instances of capital expenditure had been recorded as separate items which could not be readily linked to ascertain the aggregate cost of composite plant, machinery, and equipment. Absence of completed FAR suggested that the Ministry of Disinvestment had no mechanism to ensure that all the fixed assets had indeed been valued before making payment of fees to the asset valuer. In some cases of land and buildings, agreement/conveyance deeds had not been registered, title had not been transferred in the name of VSNL and the title/lease deed in respect of certain land and buildings were not made available to the valuer.

The Ministry of Finance admitted in May 2006 that they had no mechanism to ensure that all the fixed assets had indeed been valued but also stated that it was not required to issue any instructions/guidelines to the entities to be divested to keep their records/documents in proper shape. The valuation of a PSU's assets was done on the basis of records furnished by the PSU. The Ministry further stated that as a part of their normal functioning, the PSU was expected to maintain all the requisite documents without being directed to do so either by the administrative Ministry or DOD. The Ministry added that the Department of Public Enterprises would be requested to issue suitable instructions to all administrative ministries/ PSUs to take remedial action for ensuring that records such as the Fixed Assets Register are maintained properly. The Department of Disinvestment intimated Audit in July 2006 that the Department of Public Enterprises had issued necessary instructions on 30 June 2006 to all administrative ministries.

3.4.2.3 HTL: Audit examination revealed that the asset valuer had adopted the rate of the portion of land measuring 20.19 acres[23] (366.44 grounds) used for the factory at Rs. 15 lakh per ground and then reduced it by 50 *per cent* or Rs. 7.5 lakh per ground without mentioning and recording any reason in the valuation report. The guideline rate of land available with the Sub Registrar Office(SRO) measuring 14.98 acres (271.88 grounds) used for staff colony was Rs. 6.88 lakh per ground. These rates were also reduced by 50 *per cent* even though the land was situated in the residential area in Guindy Industrial Estate and had all civic amenities.

Two more freehold plots measuring 4.91 acres at GST Road, Chennai and 11.021 acres at Ekkattuthangal, Chennai were purchased by HTL from the State Industrial Development Corporation (SIDCO) in January 1993. The guideline

[23] *1 acre= 18.15 grounds*

rate (as per SRO Adyar) of the plot size 4.91 acres (89.11 grounds) was Rs. 27.14 lakh per ground and the prevailing rate as per the asset valuer's local enquiry was Rs. 30 lakh per ground. The valuer had deducted 30 *per cent* (Rs. 9 lakh per ground) from the market value of Rs. 30 lakh per ground on account of development of land including filling and raising of ground level and another 20 *per cent* (Rs. 6 lakh per ground) for restriction on the usage of land. The valuer worked out the final cost per ground as Rs. 15 lakh overlooking even the rate adopted by SRO Adyar.

The final rate of the plot measuring 11.021 acre (200.03 grounds) was Rs. 6.68 lakh per ground (as per SRO Saidapet). The asset valuer had taken the rate of land as Rs. 3 lakh per ground stating that the land which was vacant with growth of jungle, was situated by the side of Adyar river with sloping terrain 2 Km away from the main road and had few purchasers. The valuer had in this case also undervalued the land when compared to the guideline rate of SRO Saidapet as the latter rate would have taken into account all the relevant factors.

The Ministry of Finance in their reply (May 2006) stated that the asset valuer had clarified that the guideline value maintained at the SRO's office was for arriving at stamp duty for registration of documents and was only a guide and one of the factors to be considered in valuation. The reply was not convincing as the guideline rates fixed by State authorities were minimum threshold rates for levy of stamp duty and market rates needed to be determined with adequate and transparent justification which was not forthcoming in the valuer's report. The valuer had adopted the guideline rates and arbitrarily applied further reduction in some cases whereas in other cases, guideline rates were discarded altogether on the ground that the rates determined by the local body were higher than the guideline rates. This indicated inconsistency in approach to asset valuation, which was not a good practice and had not helped in a proper assessment of the value of the assets.

3.4.2.4 Core assets not valued

The nine PSUs disinvested and examined in audit had assets in possession including plant and machinery, leasehold and freehold land, office buildings, staff colony, guest houses, branch offices and so on which were to be classified as core assets or non core assets depending on the direct contribution to the core activities such as manufacture, production or operations of the business or otherwise. Audit examination revealed that core assets were not valued in the asset valuation methodology in some cases.

MFIL: The asset valuer had not valued the plant and machinery as it was not considered necessary. DOD stated, in March 2001, that the entire plant and machinery of MFIL was of the sixties and seventies vintage and used slower speed technology which was no longer in vogue. DOD added that under the assumed scenario of the sale of the company, asset by asset, MFIL management was of the view that these plants would not be able to realize any significant amount and might be sold as 'scrap'. GA went along with the view stated to have been taken by

the management of MFIL without making any independent assessment and stated that plant and machinery and other miscellaneous assets were not valued in view of their old age, operational inconvenience and time constraint.

Audit noted that the book value of plant and machinery was Rs. 8.64 crore as on 31 March 1999. The asset valuer did not determine the depreciated replacement cost of the plant and machinery though GA had taken operational capacity for bread making units as 100 *per cent* of the installed capacity while working out the enterprise value under the discounted cash flow method. Audit examination of the technical bid of the strategic partner revealed that the latter had acknowledged that there was hardly any technology development in the bakery industry for the last few decades, the plants of MFIL were well maintained and were in satisfactory working condition to deliver designed output levels. Therefore, not carrying out an appropriate assessment of the value of core assets was an omission.

Further, leasehold land of one plant of MFIL based in Delhi was not valued by the asset valuer on the premise that it was certified as incapable of being used for any other commercial operation except food processing. The fact that it could still have been of some value for being used for bakery operations and possible future expansion of such operations, was ignored. Similarly, the value of land leased for 30 years of the Silchar Unit was ignored on the ground that only 18 years of lease period was left and that there was usage restriction on the land. With an available lease period of 18 years, which was more than 50 *per cent* of the total lease period, land could not have been left unvalued by any measure of ordinary prudence, which was an omission on the part of the asset valuer and GA.

BALCO: The asset valuer had excluded the value of leasehold land housing the plant and township besides the ropeway and railway siding in Korba and the accommodation in SCOPE Complex building in New Delhi while valuing the assets. The valuer had stated in his report that in respect of leased land, lease deeds had not been executed by BALCO, the terms and conditions were not known and it was not clear whether BALCO could transfer the land to another company. Hence a notional value of Rs. 13.16 crore on profit rent method[24] was arrived at by the asset valuer for the above assets except SCOPE Complex. Audit noted that this notional value had not been included in asset valuation.

BALCO was also paying rent to NTPC for its captive power plant in Korba (BCPP) located on leasehold land for which the asset valuer had determined a

---

[24] ***Profit rent method*** *- Normally this method is used to calculate the market value of leasehold land and rented buildings (income approach), under which profit rent is taken as the difference between market rent and actual lease rent of the property. Conditions of lease including conditions for its transfer, lease rent and provisions for revision, total period of lease, remaining period of lease, conditions for renewals should be taken into account while valuing the property apart from encumbrances, if any and land usage restrictions, which have a direct bearing on prices.*

notional value of Rs. 1.45 crore under the profit rent method. This value was ignored by the asset valuer while finalizing the asset valuation.

The Ministry of Disinvestment stated (December 2001) that value of the lease land was not reckoned since no lease deed was executed between BALCO and the state government. The contention of the Ministry was not tenable as these assets remained with BALCO and it was the immediate responsibility of the administrative Ministry to have ensured that clear titles to the land in possession of the PSU were in place before the disinvestment. Since BALCO was a separate legal entity and merely ownership structure was changing, the value of leasehold land should have been reckoned in the asset valuation. Even if sale or transfer of land was not permissible, at least the value on the basis of profit rent method should have been reckoned. Exclusion of the value of leasehold land resulted in undervaluation.

Audit further noted that the value of the space occupied by the PSU having plinth area of 2643.10 square meters in the second, third and sixth floor in the SCOPE Complex, a building in New Delhi housing the offices of PSUs was not taken into account in the valuation. The asset valuer had mentioned in the valuation report that 60 *per cent* of the market value was the effective value as free sale was not generally allowed in SCOPE Complex. However, even this value was considered a notional value, and was not included in the overall value of the PSU's assets by the valuer in view of perceived lack of clarity at the time of valuation as to whether BALCO would be allowed to continue their office in this space after disinvestment.

The Ministry of Finance in their reply (May 2006) stated that at the time of valuation of BALCO, the position was that the office accommodation in SCOPE Complex might not be allowed to be transferred or sold to a private company and hence it was considered of notional value and not included in the asset valuation. Audit noted that a clarification was provided to all the bidders that suitable compensation would be given to all the bidders in case use of SCOPE Complex was denied to the successful bidder after disinvestment. There was no ambiguity in continuation of use of space by BALCO in SCOPE Complex after disinvestment and therefore at least 60 *per cent* of the market value as mentioned by the asset valuer should have been included in the value finally arrived at.

The Ministry further stated that economic useful life of the plant and machinery was 20 years and since, the plant was over 28 years old, it had outlived its useful economic life and residual value was scrap value at 10 *per cent* of the replacement value which worked out to about Rs. 168 crore. Moreover, being an obsolete and uneconomical plant without any modernisation, the plant was not likely to attract buyers. However, since the plant was in working condition, a higher residual value of Rs. 247 crore was adopted in the valuation report. This higher value covered doubtful assets like leasehold land/properties and the value of space occupied by the PSU in SCOPE Complex.

Ministry's reply that the asset valuer had kept a cushion of Rs. 79 crore (Rs. 247 crore minus Rs. 168 crore) in the valuation to take care of doubtful assets like leasehold land/properties and other items including the value of SCOPE building

was contrary to the views expressed by the valuer in the valuation report where the valuer had stated that the plant still had a residual life of five years. Thus, the valuation of the plant and machinery was actually on the lower side and there was no cushion in valuation provision.

HZL: The PSU operated six mines comprising three Lead-Zinc, two Lead and one Rock-Phosphate mines located in Rajasthan, Orissa and Andhra Pradesh. While GA had treated three mines as non-core assets, the asset valuer in his valuation had assumed that five mines were inoperational and had exhausted their economic life. The asset valuer had worked out the value of five mines on the basis of realizable value and one mine on the basis of market value. As GA had assumed only three mines as non-core, the asset valuer should have valued not one but three mines on the basis of market value. This underlined the need for ensuring consistency in assumptions in the valuation procedure adopted between GA and the asset valuer.

The Ministry of Finance in their reply (May 2006) stated that the asset valuer had valued Zawar and Rajpura Dariba mines on realizable value since mining operations were suffering from incurable problems and in such a scenario, a prudent management or a prospective buyer was not likely to continue with the operations. GA had, however, not considered the operation of these two mines as loss making. Rampura Agucha mines were valued on the basis of market value because past analysis had indicated that these mines were showing a very healthy profitability and the forecast also suggested that this profitability was likely to continue. The Ministry's reply would indicate that GA had erred in their assumptions while arriving at the enterprise value under the DCF method, which would imply that the valuation under DCF methodology was incorrect or inaccurate. Either way the Ministry did not appear to be aware of the adverse implication on the valuation, especially under the asset valuation method till it was pointed out in audit.

IPCL: Audit examination revealed discrepancies in the value of the Gandhar Plant shown in the summary of the valuation schedules (Rs. 4829 crore) and that in the unsigned certificate by the asset valuer (Rs. 1924 crore). The Ministry of Finance in their reply (May 2006) stated that the asset valuer had regretted the discrepancy which was a bona fide mistake caused by pure inadvertence and there was no intention to mislead. The asset valuer had further stated that Rs. 4829 crore as mentioned in the summary of valuation schedules of the valuation report was the true and correct present value of the Gandhar Plant**.** Though the correct value was ultimately adopted in the valuation exercise, the discrepancy did not serve to assure the quality of diligence of the asset valuer.

3.4.2.5 Intangible assets not valued

Asset valuation should include the value of intangible assets as the PSUs tend to build over the years a lot of goodwill, brand value, distribution network and customer relationships, all of which become very important to determine their true intrinsic value. Audit noted that that PSU/ Ministry concerned who

appointed the asset valuers had not specifically assigned the work of valuation of intangible assets in any of the nine PSUs under examination in audit. In the case of **IPCL,** the PSU had been granted 12 patents including 8 international patents, which were not considered for valuation. The intangible assets were also not valued in the case of **MFIL, BALCO** and **IBP.** The Ministry stated (March 2001) in the case of **MFIL** that there was no need to value intangibles separately as the Government had no intention to sell the intangibles separately and that it was already taken into account in the Discounted Cash Flow (DCF) method. Similarly, the Ministry replied in the case of **BALCO** that the brand value had been reflected in DCF value. The Ministry of Finance in their reply (May 2006) stated that the guidelines on valuation issued by the DOD already took into account the fact that intangible assets were not to be included in the asset valuation report. The Ministry further stated that due to limitations of the asset valuation approach, the advisors held that the Discounted Cash Flow approach might be the most appropriate methodology to be relied upon for valuing businesses on a going concern basis. The Ministry's reply was not tenable as inclusion of the value of intangibles under DCF method could not be a valid ground for its exclusion under the Asset Valuation method as the two are distinct and separate methods and valuation under each method had necessarily to provide a complete and reliable picture of the value of the business under disinvestment**.** While the Ministry's reply was silent in the case of **IBP** and **IPCL,** audit examination revealed that in the case of **PPL,** the Ministry had clarified that the asset valuer had valued the intangible assets amounting to Rs. 4.61 crore. Thus, the Ministry of Disinvestment allowed inconsistent treatment of the same issue of valuation of intangible assets under the asset valuation methodology across the nine PSUs covered in this report.

3.4.2.6 Capital works in progress (CWIP) not valued

In the case of **BALCO** and **IBP,** the value on account of CWIP was not added to the value of the fixed assets while arriving at the adjusted asset value[25] under the asset valuation method. The Ministry of Finance in their reply (May 2006) stated that in respect of **BALCO,** CWIP amounting to Rs. 204.6 crore had been considered in the balance sheet valuation methodology as the installation of a new Caster and Cold Rolling Mill was expected to be completed by the end of February 2001. In the asset valuation report, a sum of Rs. 153 crore (90 *per cent* of new replacement cost of Rs. 170 crore) was added towards this mill. Reasons for not adding the full cost along with the cost of installation to the value under asset valuation method could not be ascertained in audit. In the case of **IBP,** the Ministry of Disinvestment replied that the total value of CWIP in the books of the PSU was Rs. 17.12 crore as on 31 March 2002 and the value of work in progress was taken into account in the balance sheet valuation methodology. The Ministry's reply was not tenable as CWIP was not taken into account in the asset valuation method.

---

[25] ***Adjusted Asset Value*** *under the Asset Valuation Methodology is the amount realizable by selling off all the assets and paying off all liabilities of a business under liquidation scenario.*

3.4.2.7 Inconsistent approach in calculation of capital gains tax

Asset valuation normally reflected the amount which might be required to be spent to create a similar infrastructure as that of a business to be valued or the value which might be realised by liquidation of the business through the sale of all its tangible assets and repayment of all liabilities. Thereafter, adjustment for an assumed capital gains tax consequent to the hypothetical outright sale of these assets and adjustment to reflect realization of working capital and settlement of all liabilities (including voluntary retirement to all the employees) were required to be made from the gross asset valuation arrived at by the asset valuer. GA was to make the above adjustment and arrive at the adjusted asset value, which was an index of the value of the assets realizable from the liquidation of the business. Capital gains tax was a post-sale liability and would detract from the intrinsic value of the company. Factoring in capital gains tax would correspondingly lead to under valuation of assets by the same amount.

Audit noted that capital gains tax liability was worked out and deducted from the asset valuation only in the case of **MFIL, HTL, CMC** and **PPL** while in the case of **BALCO, IBP, IPCL, VSNL** and **HZL,** GAs had not deducted capital gains tax to arrive at the net asset value.

In the case of **MFIL**, GA had assumed capital gains tax of Rs. 9.96 crore on the sale of assets. The Ministry in their reply (April 2001) stated that GA had factored in capital gains tax by treating all MFIL sales being subject to corporate tax provisions applicable to companies. In the case of **HTL**, GA had deducted Rs. 21.38 crore on this account to arrive at net asset value and the Ministry replied that capital gains tax had been deducted on the basis that the net asset value represented the value that a prospective buyer of shares of HTL would realize if he were to undertake a sale of the assets. In the case of **CMC**, GA had made adjustment of Rs. 37.45 crore on this account. The Ministry in their reply stated that since the assets were currently owned by CMC, it would be the beneficiary of such a transaction and hence capital gains tax would be payable by CMC. While in the case of **PPL,** GA had deducted Rs. 132.55 crore on this account to calculate net asset value, in the case of **HZL**, GA had not calculated the capital gains tax since the relevant information was not available whereas in the case of **IBP,** no reason was found recorded for not taking into account the capital gains tax.

The Ministry of Finance in their reply (May 2006) stated that the guidelines on valuation issued by the Department of Disinvestment (DOD) laid down that capital gains tax was to be deducted from the value of assets The reply only highlighted the fact that the valuation process was inconsistent with the guidelines in this regard in five out of nine PSUs covered in this report. The inconsistency had the impact of inflating the asset value in the case of the above mentioned five PSUs to the extent of capital gains tax liability in each case which could not be quantified in audit.

The Ministry being the nodal agency entrusted with the responsibility of piloting the entire process of disinvestment, ought to have taken up the preparatory work to increase the robustness of the asset valuation methodology more seriously by taking stock of all the aspects including such preliminary and fundamental requirements as clear titles, full details of all assets, demarcation of core assets[26] and consistent procedure of valuation under the asset valuation method. In the absence of such preparation and not much positive action or suggestions forthcoming in a transparent form generally from GAs, the process of asset valuation ended up being of no real help to the decision making authorities in correctly assessing the value of the PSU through this method. The expenditure incurred on the engagement of asset valuers amounting to Rs. 1.19 crore in eight cases (excluding the fees paid in the case of IPCL) of disinvestment covered in this report might not appear substantial compared to the quantum of total sale proceeds received by Government. Nevertheless, it was found in audit that this expenditure did not serve any useful purpose.

3.4.3 Balance Sheet Valuation Methodology

This method assumed that the value of the business equalled the value of assets as reflected in the financial statements. It was expected to provide an additional indicator of the value of the business being disinvested. Audit examination of the valuation done under this methodology in respect of **PPL** revealed that GA had made provision on account of contingent liabilities of Rs. 47.89 crore towards interest on delayed payment to the foreign suppliers, payment to the contractors and customs duty without mentioning the details of computation of such provisions. Audit noted that these provisions were not reflected in the annual reports of the PSU. Thus, the liability of the PSU was inflated, which had the overall effect of reducing its value under this method. The Ministry of Finance stated in reply (May 2006) that the details of contingent liabilities alongwith the amount as communicated to GA, as well as to the bidders by PPL, were considered by GA as well as bidders, as such. Audit could not verify PPL's communication to GA and no document regarding any discussion of GA with the management of the PSU was made available.

3.4.4 Transaction Multiple Methodology

Audit examination revealed that this methodology and/or the comparable companies methodology was adopted by GA in respect of all nine PSUs covered in this report. There were no significant audit comments.

3.4.5 Inconsistencies noticed in the valuation methodologies

As per the Accounting Standard 29 issued by the Institute of Chartered Accountants of India, a contingent liability was a possible obligation that arose from the past event and existence of which would be confirmed only by the

---

[26] ***Core assets –*** *Assets without which a company can not operate, all other assets are considered as non-core assets.*

occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the company. These obligations could be on account of

- claims against the company not acknowledged as debt,
- uncalled liability on shares partly paid,
- arrears of fixed cumulative dividends,
- estimated amount of contracts remaining to be executed on capital accounts and not provided for, and
- other money for which the company is contingently liable, etc.

An enterprise should not recognize the contingent liability but should disclose the same in the financial statement.

3.4.5.1 Audit examination of nine disinvested PSUs with regard to the deduction of amounts of contingent liability revealed that GA concerned had, while valuing **IBP** deducted Rs. 59 crore under the DCF and balance sheet methodologies but no amount was deducted under the asset valuation methodology. In the case of **PPL** while no deduction was made under the DCF methodology, an amount of Rs. 47.89 crore was deducted under the asset valuation methodology and the balance sheet valuation methodology towards contingent liability. GA had deducted Rs. 630 crore under both the asset valuation and the balance sheet valuation methodologies in **IPCL** but Audit could not verify, in the absence of details, the amount of deduction on account of contingent liabilities under the DCF methodology though GA had deducted an amount of Rs. 4275.75 crore as net debt. Audit examination also revealed that in the case of **MFIL, BALCO, HTL, CMC, HZL** and **VSNL** though the annual accounts had mentioned contingent liabilities, no deduction was made by GA in any methodology of valuation.

3.4.5.2 The Ministry of Finance in their reply (May 2006) stated that they had relied on the judgment of the advisors, who were reputed experts in their field and were appointed in a transparent manner. The Ministry also stated that they had prepared a booklet on guidelines on valuation of PSUs that were being disinvested through strategic sale and that as far as possible, valuation was recommended by the advisors in accordance with these guidelines. It might also not be possible to have exhaustive guidelines on treatment of all individual items and adjustments. The reply only served to highlight the fact that the reputation and transparent appointment of advisors by themselves would not necessarily have ensured completeness, accuracy and consistent execution of valuation and that the Ministry needed to put in place a more effective mechanism of scrutiny of the results of valuation by providing the required time to the process and also seriously reconsider issuing specific guidelines to the valuers/advisors in future.

3.4.6 Fixation of Reserve Price

Audit noted that four methodologies namely **Discounted Cash Flow (DCF), Comparable Companies, Balance Sheet Valuation** and **Asset Valuation methodologies** were broadly followed by GAs for valuing the PSUs. GA arrived at the values under the first three valuation methodologies independently whereas the asset valuer worked out the value of all the fixed assets under the asset

valuation methodology. Thereafter, GA made certain adjustments assuming hypothetically liquidation scenario on account of voluntary retirement scheme, capital gains tax and the net current asset value to the asset value. The valuation reports of GA and Asset Valuer were handed over to the Evaluation Committee. GA made presentation on the valuation of a PSU under all the four methodologies to the Evaluation Committee for enabling the Committee to arrive at the reserve price for both the listed and unlisted PSUs. Audit also noted that EC recommended the reserve price on the basis of the business valuation arrived at under the DCF methodology in seven out of nine PSUs examined in this report. GA was required to add the value of non-core or surplus assets of the PSU to the business value arrive at under the DCF method for fixation of the reserve price by Government.

Table 7 indicates the values arrived at under different methodologies of valuation in the nine PSUs examined in this report.

Table 7: PSU- wise values arrived at under different methods

(Rs. in crore)

Sl. No.	Name of PSU	Percent -age of equity divested	Value of 100 *per cent* equity of the Company arrived at under			
			Discounted Cash Flow Method	Asset Valuation Method*	Comparable Company's Method	Balance sheet Method
1	**MFIL**	74	(i) 62.23 *Growth in bread market* (ii) 68.77 *on closure of Supplementary Nutritional Foods (SNF) business* (iii) Nil *on as-is-where-is basis*	68.18	78.55 *(Transaction/ Sales Multiples)*	28.51
2	**BALCO**	51	793 (651.2- 994.7)	1054.9- 1072.2 *(Replacement basis)*	587- 909	597.2- 681.9
3	**HTL**	74	52.44	52.79	40.31	57.47
4	**CMC**	51	213.49	37.58	102.53	72.74
5	**IBP**	33.59	1124	445	1012 – 1382 *(EV/ EBIDTA)* 972 – 1188 *(P/E)*	608
6	**VSNL**	25	4873.5 (4560- 5757)	5301	5871 (5500.5-6241.5)	4018.5
7	**PPL**	74	111.80	(i) 206.25 *(Liquidation basis)* (ii) 495.00** *(Replacement basis)*	*Not applied by GA*	48.90
8	**IPCL**	26	3251.8	3673.7#	3648.9	2554.4
9	**HZL**	26	1215 (1073- 1356)	1619.0	1232.6 (1023-1422)	1186.9

** Under the asset valuation method, adjusted asset value was considered by GA assuming liquidation scenario in eight out of nine PSUs except BALCO. GA had made adjustments to the asset values worked out by asset valuer on account of voluntary retirement scheme, capital gains tax and added net current asset values to arrive at the adjusted asset value.*

*** In the case of PPL, GA considered replacement assets value arrived at under the assets valuation method while suggesting the reserve price to the Evaluation Committee.*

 # Asset valuer had valued the fixed assets at Rs. 4637.6 crore in September 2000 and GA used discount rate of 11.7 per cent on asset valuation in May 2002 to arrive at the value of Rs. 3673.7crore for 100 per cent equity. The adjusted value worked out to Rs. 955.2 crore for 26 per cent @ Rs. 148 per share.

3.4.6.1 Audit examination revealed that while in the case of **MFIL**, reserve price was not fixed and no reasons were recorded for the same, in the case of **PPL**, the reserve price was determined by deriving the composite value by assigning a weightage of one to the asset replacement value as per the asset valuation method and a weightage of two to the value arrived at under DCF methodology. The weightages were stated to have been assigned as there was a huge disparity between the DCF value and the value of the business ascertained by the asset replacement method.

3.4.6.2 Before fixing the reserve price on the basis of the valuation of business arrived at under DCF methodology, GA concerned was required to compute the value of non core or surplus assets of each PSU and add the same to the value of the business arrived at since non core assets[27] were not reflected in the cashflow under this methodology. Audit examination also revealed other deficiencies and inconsistencies in the valuation of non core assets even as it was not possible to ensure that the addition made was complete as in the case of **BALCO** and **IPCL,** as detailed below:

BALCO: The asset valuer had valued roads, compound walls, water supply lines and drains of Bidhan Bag Unit at Rs. 25 lakh and these were considered non-core assets. However, while exhibiting this amount in the summary sheet, the value of this item was categorised as core item by the valuer. Similarly, value of two company flats (Rs. 28 lakh) in Mumbai were not taken in the summary sheet and hence remained excluded from the value of non-core assets. Both the mistakes together led to incorrect valuation of non-core assets by Rs. 53 lakh. The Ministry of Finance in their reply (May 2006) stated that there appeared to be some misclassification / omission of core and non-core assets as pointed out by Audit. However, the amounts involved were extremely small and would not have affected the overall valuation.

IPCL: GA had segregated surplus/non-operating assets for Vadodara Unit under DCF methodology in December 2000. These assets were valued at Rs. 214.99 crore and thereafter, the amount was added to the value arrived at under DCF methodology. However, while revaluing the PSU in May 2002, GA assessed the present value of the non operating or non core assets including those in Vadodara, Nagothane, Gandhar complexes and other facilities at Rs. 74.1 crore without providing the details of such assets in each unit. Reasons for adoption of the value of non-operating or non core assets in May 2002 on the lower side compared to that arrived at in December 2000 by the same GA were not ascertainable in audit. This difference had the impact of reducing the enterprise value of the PSU. The Ministry of Finance in their reply (May 2006) stated that the comments of GA had been called for and their reply was awaited.

---

[27] ***Non-core assets****- Assets which do not generate cash for the company are considered non-core assets. Valuation of these assets assumes importance due to the fact that all non-core assets are to be added to the DCF valuation to arrive at final DCF valuation, which is taken as most accurate assessment of value of company for determining reserve price in a strategic sale.*

3.4.6.3 The Ministry of Finance in their reply (May 2006) stated that the classification of assets into core and non-core depended on the recommendations of the advisors, who were reputed experts in their field and were appointed in a transparent manner. Had the non core assets been identified and valued properly this would have helped the EC in arriving at a more accurate and complete assessment of the enterprise value and in fixing the reserve price properly in these two cases.

3.5 Relevance of the market price of shares

The manual of the policy and procedure of disinvestment of DOD had provided that in the case of listed PSUs, the market value of shares during the last six months could also be used as an additional indicator for fixing the reserve price. Audit examination revealed that in the case of **CMC,** EC considered the market price to be distorted and ignored it for fixation of the reserve price, whereas in the case of **IBP**, GA had stated that the market performance might not be truly reflective of the underlying value of IBP due to increased volume in the trade buying versus long term institutional investing. In the case of **VSNL,** GA had stated that it was not enough to rely solely on the PSU's current market valuation. Audit noted that in the case of **HZL** disinvested in March 2002, GA had, apart from the four valuation methodologies suggested valuation on the basis of traded scrips of the company for both rounds of valuation in November 2001 and March 2002. EC which met on 8 November 2001 and 22 March 2002 considered the average share price of HZL for 6 months. In the case of **IPCL,** GA had not discussed the market value of the company's scrips for valuation. However, EC had not discussed the market price of the company while determining the reserve price, in any of these cases except **CMC** and **HZL**.

The Ministry of Finance in their reply (May 2006) stated that the guidelines on valuation issued by the Department of Disinvestment prescribed valuation by four methodologies but the suggestion of Audit that the relevance of market price should not be ignored while fixing reserve price would be examined separately.

3.6 Inadequate documentation in support of examination of valuation by Evaluation Committee.

3.6.1 The Evaluation Committee (EC) was the main technical expert committee for examining the techno-economic details of GA's assumptions contained in valuation reports and make recommendations for the fixation of reserve price to the IMG. Other committees in the approval channel mainly relied on EC's technical opinion. Audit noted that except in the case of IPCL, the EC and IMG had given their recommendations on reserve price within a day, which would appear to have been rather insufficient for analyzing the number and complexity of the assumptions made in the valuation reports, considering the fact that members of this Committee were given valuation reports in the same meeting. The Ministry of Finance in their reply (May 2006) stated that they had devised an elaborate and comprehensive system for evaluation of bids. EC, which evaluated

the bids considered the presentations made by GA, valuation reports, and made recommendations after due deliberations

3.6.2 Audit noted that EC had considered the DCF value to determine the reserve price of the nine PSUs except **MFIL** and **PPL**. However, the valuation reports of GA were not self explanatory in the case of **IPCL** and **HZL** as detailed justification of the projections were not made**.** Audit also noted that the recommendations of GA on valuation were reviewed only broadly without evaluation or analysis of the underlying assumptions. In most cases, wide variations were observed between the reserve price fixed by Government and the financial bid finally accepted, as indicated in Table 8.

Table 8: Comparison of reserve price and sale value of PSUs disinvested

(Rs. in crore)

Sl. No	Name of PSU	Reserve price fixed by Government	Final bid price accepted	Percentage variation between the reserve price and the final bid price
1	**MFIL**	Not fixed	105.45	**--**
2	**BALCO**	514.40	551.50	**7.2 above**
3	**HTL**	38.80	55.00	**41.75 above**
4	**CMC**	108.88	152.00	**39.6 above**
5	**IBP**	377.00	1153.68	**208.66 above**
6	**VSNL**	1218.37	1439.25	**18.13 above**
7	**PPL**	176.09	151.70	**13.85 below**
8	**IPCL**	845.00	1490.84	**76.33 above**
9	**HZL**	353.17	445.00	**26.00 above**

In the case of **MFIL,** the reserve price was not fixed, and a range of values from negligible to Rs. 78.55 crore for 100 *per cent* equity was arrived at under four methodologies. In addition, SP had offered to invest Rs. 20 crore in the divested company to meet its immediate financial needs of liquidity and upgradation of plant. Due to erosion of the net worth for the period ending 31 December 2000, the company was referred to BIFR in April 2001. The remaining cases are discussed below.

BALCO: The Ministry of Mines received two financial bids (February 2001) out of which only one bid at Rs. 551.50 crore was above the reserve price of Rs. 514.40 crore recommended by the Evaluation Committee. The second bid quoted at Rs. 275 crore was Rs. 239.40 crore below the reserve price fixed.

CMC: The Ministry received a single bid for sale of 51 *per cent* equity for a consideration of Rs. 152 crore which was higher than the reserve price of Rs. 108.88 crore by Rs. 43.12 crore.

HTL: Two financial bids were received by the Ministry at Rs. 55 crore and 50 crore against the reserve price of Rs. 38.80 crore. Audit noted that the SP had submitted a post closing adjustment claim of Rs. 56.49 crore (September 2002)

which was under consideration of Government and in the meanwhile the company had been referred to BIFR in July 2003.

IBP: The Ministry of Disinvestment received seven bids and two out of seven bidders were public sector undertakings. All the seven bidders had quoted their bid price above the reserve price of Rs. 377 crore recommended by EC. The highest price quoted by IOC, a PSU was Rs. 1153.68 crore and the second bidder had submitted a financial bid of Rs. 595.02 crore against the reserve price of Rs. 377 crore.

VSNL: The Ministry received two bids (February 2002) and both the bids were above the reserve price fixed at Rs. 1439.25 crore. The bid quoted by the highest bidder was higher than the other bid by Rs. 92.62 crore.

PPL: The single financial bid received for Rs. 151.70 crore was below the reserve price of Rs. 176.09 crore recommended by EC by giving a weightage of two to DCF value and one to replacement asset value. The reason recorded by EC for recommending the acceptance of financial bid below the reserve price was that weightage to asset valuation had increased the reserve price and the company was incurring losses of Rs. 10 to12 crore per month. Audit noted that the Strategic Partner had submitted (December 2002) a post closing adjustment claim of Rs. 151.55 crore which was under examination in the Department of Fertilizers. The Department of Fertilizers intimated audit (July 2006) that a reference was filed in BIFR (February 2003) after the net worth of the PSU became negative after the disinvestment and PSU was formally declared sick in July 2005.

IPCL: The Ministry received financial bids from three bidders, and one of the bids was from another PSU. Out of the three bids received, two were below the reserve price fixed at Rs. 845 crore. The Strategic Partner had submitted claims of Rs. 927.41 crore and the matter was under examination of the Department of Chemicals and Petrochemicals.

HZL: In the second round of bidding (March 2002), two financial bids were received by the Ministry. Both bids were above the reserve price of Rs. 353.17 crore. The bid amount of Rs. 445 crore quoted by the same bidder by forming a consortium was substantially higher than the bid of Rs. 321 crore offered in the first round.

3.6.3 While the unusually high variation in the case of **IBP** could be attributed to the extraordinary importance attached to it by another PSU in order to ensure the latter's sustenance and future, the other cases would need to be viewed against the background that in the case of **BALCO, HTL** and **PPL**, Government continued to grapple with post adjustment claims of Rs. 16.72 crore, Rs. 56.49 crore and Rs. 151.55 crore respectively, where as in the case of **IPCL**, SP had preferred third party claims of Rs. 927.41 crore. These claims had the potential of wiping off almost the entire realization from disinvestment of **HTL** and **PPL** and in the case of **IPCL**, settlement of these claims in favour of SP would reduce the receipts of the Ministry by 62.20 *per cent*. Thus the amount of effective

realization and outcome from the disinvestment of four out of nine PSUs was far from clear (May 2006).

The Ministry of Finance in their reply (May 2006) stated that the fact that the bids were substantially higher than the reserve price showed that Government was able to ensure aggressive bidding by generating competition. It further stated that the advisors for these transactions were reputed experts in their field and were appointed through a transparent process. The Ministry in the same reply also stated that the advisors were supposed to maintain supporting information in connection with their valuation reports and in future, they would be specifically asked to maintain such information and preserve it for the audit requirements of Government.

3.6.4 The Ministry's reply has to be viewed against the fact that in only two out of the nine cases of disinvestment examined in this report, there were more than two financial bidders as indicated in paragraph **3.7.1** subsequently. Further, though 70 bidders or interested parties had been short listed by the Ministry, as many as 48 (69 *per cent*) had withdrawn from the bidding process encompassing the nine PSUs under examination. The real test of the expertise and reputation of the advisors and the transparency of the process of their appointment would have to be the effective competition generated in terms of the number of financial bids and the value addition in terms of making the sale attractive to the prospective bidders through their specific efforts, including consistent and transparent valuation exercises.

3.7 Competition generated in the bidding process was not satisfactory.

3.7.1 Audit noticed a general trend in the disinvestment of PSUs under examination that a majority of bidders who had initially submitted their EoIs withdrew during the process of due diligence[28] limiting the competition as evident from Table 9. Some evidence of reasons for withdrawal were observed only in the case of **CMC, VSNL** and **HZL.**

Table 9: Details of the bidding process for the selection of Strategic Partner

	MFIL	BALCO	HTL	CMC	PPL	VSNL	IBP	IPCL	HZL
No. of EoIs received	10	7	6	14	4	6	15	4	9
No. of parties short listed	10	5	4	14	4	6	15	3	9
No. of parties, which conducted due diligence	4	3	4	11	3	4	12	3	7
No. of financial bids received	1	2	2	2	1	2	7	3	2

[28] ***Due diligence exercise*** *is the task of carefully confirming all critical assumptions and facts presented in order to assess the desirability, value and potential of the business.*

MFIL: Out of the four companies which were provided with the draft agreements only one submitted its bid on the due date while another bidder requested for extension of time by two more weeks for submitting the bid, which was not considered by the IMG. This led to a situation where there was effectively only one bidder in the race. The Ministry of Finance in their reply (May 2006) stated that various bidders dropped out due to their own internal reasons and among the two final bidders, the one who dropped out in the final stage of bidding did not state shortage of time as the reason for non submission of the price bid.

BALCO: Two out of five firms showed their unwillingness in submitting the financial bid and three firms were short-listed by IMG. The Ministry of Mines which was handling the disinvestment in the initial stages received financial bids from two firms, whereas the third bidder showed its unwillingness in submitting the financial bid but the reasons were not documented. The Ministry of Finance in their reply (May 2006) stated that the bidders were not bound to continue with the bidding process, and were free to withdraw at any stage without giving any reasons for their withdrawal.

CMC: Out of initial 14 interested parties, 11 carried out due diligence, but only two financial bids were received of which one bid was not accompanied by the bank guarantee and was thus rejected. This left only a sole bidder in the fray.

IPCL: Audit could not verify the details of the bidding process of the two rounds of bidding, as the relevant records were not produced. Audit noted that GA had rejected EoI's for three International bidders without even informing the Ministry about the details of the bids or the reasons for their rejection. The Ministry of Finance in their reply (May 2006) stated that the details had been called for from GA and would be supplied to Audit when received.

PPL: A single bid received was below the reserve price and the other bidder was stated to have expressed inability in submitting the financial bid**.**

HZL: In the first round of bidding in November 2001, one financial bid was received while the other bidder had submitted a regret letter. In the second round of bidding in March 2002, while two bidders submitted financial bids, the third bidder submitted a regret letter again.

3.7.2 The efforts of the Ministry in generating competition to obtain the best value for the stake under disinvestment of the PSUs would have been appreciated better in audit if it had maintained the log of contact and communications between bidders and GA and the reasons for the withdrawal of as many as 48 out of 70 short listed bidders. This would also have strengthened the good practices in disinvestment and helped in improving transparency of the process.

The Ministry of Finance in their reply (May 2006) stated that the bidders were not bound to continue with the disinvestment process and were free to withdraw at any stage, without giving any reasons to the Government. However, the suggestion of Audit that GA should maintain a log of all contacts with

prospective bidders would be kept in view in future. It further stated that in the recently concluded disinvestment of 8 *per cent* equity in Maruti Udyog Limited (MUL), a suitable clause to this effect was incorporated in the mandate letter issued to the advisors.

Recommendation

The specific steps taken by the Ministry throughout the sale process and the steps taken by the Global Advisor to keep the interest of prospective bidders alive in order to ensure proper competition need to be documented. The documentation could include the directions and guidelines issued to the Global Advisor at each stage of bidding , detailed record of the minutes of the meetings of the decision making bodies in the approval channel and discussions with the management of the PSU. A log of all contacts and a record of all questions raised by prospective bidders with the Global Advisor and the clarifications given should also be maintained.

3.8 Problems arising out of Share Purchase and Share Holders agreements.

Two principal documents, namely, the share purchase agreement (SPA) and the share holders agreement (SHA) were signed by SP and administrative Ministry. While SHA essentially contained clauses, which laid down the relationship between SP and Government once the PSU was transferred to SP, the SPA contained the details of price and the mechanism of transfer of the disinvested shares to SP. In the case of unlisted PSUs, Ministry had incorporated a post closing adjustment clause in SPA according to which the difference between the position of net working capital and debt as on the date of the last audited balance sheet and that on the date of purchase of disinvested shares by SP was to be worked out by a jointly appointed accounting firm. Government was required to make good the difference to SP in case of depletion in the net working capital and increase in debt, and vice versa. Similar clause was not included in the case of listed PSUs ostensibly on the ground that the state of affairs of such PSUs would be generally in public domain besides the availability of the value of the shares on stock exchanges whereas such information was not available in the case of unlisted PSUs. SHA also provided an exit mechanism to both SP and Government. Normally there was a lock-in period ranging between three and five years for SP before which it could not sell whole or part of purchased shares. Similarly, SHA incorporated a road map for complete exit of Government through two options, namely put option and call option. Other provisions included the right of first refusal given to SP in the case of Government exiting from the disinvested PSU and sale of shares to employees of PSU. While the call option gave the right to SP to buy the shares from Government at a specified rate on or before a specified date, the put option gave the corresponding right to Government to sell more shares to SP at a specified rate on or before a specified date.

3.8.1 Audit noted that in the case of **MFIL, CMC, IBP, PPL** and **IPCL,** Government had retained the option of exercising put option before the exercise of call option by SP in the share holders agreement. In these cases, SP could not purchase shares from Government at the time of their choice by exercising their right. In the event of Government not exercising its put option, SP could purchase shares from Government by exercising its call option only on the expiry of time duration of the put option. Audit also noted that the put option was not included in SHAs in the case of **BALCO** and **VSNL** whereas both the options were not included in **HTL**.

In the case of **CMC**, the Ministry disinvested the residual equity shareholding of 26.25 *per cent* through offer for sale in February 2004, whereas in the case of **VSNL**, SP had the right to exercise call option which had become effective in February 2006. The Department of Disinvestment intimated audit (May 2006) that SP had not exercised the call option in VSNL. In the case of **HZL,** SP was allowed to exercise call option to purchase shares of Government without any restriction on subsequent sale of shares. The SP served the call option notice to the Ministry of Mines on 29 August 2003, which Government accepted on 11 November 2003. SP purchased 18.92 *per cent* of the equity of HZL representing 7,99,50,657 shares at a unit price of Rs. 40.51. Audit further noted that the then market price of HZL scrip was on increasing trend and the closing price of Rs. 119.10 was much higher on 11 November 2003, the day on which the Government accepted the offer of SP. The difference between the prevailing market price and the price at which SP purchased shares under call option presented a potential arbitrage opportunity[29] to SP as there was no restriction on further sale of these shares. The Department of Disinvestment stated (March 2006) that the call option exercised by SP was accepted as per terms of the SHA approved by the competent authority. Audit examination also revealed that a similar call option flowing from the SHA in the case of **BALCO** had been sought to be exercised by SP on 19 March 2004 but was, under the consideration of the administrative Ministry (May 2006). The Ministry of Finance in their reply (May 2006) stated the transaction documents of these disinvestments were company specific depending on the facts and circumstances of each case. The full implications of the call and put option clauses under the SHA finalized by DOD, therefore were ascertainable only long after the disinvestment of the stake by DOD.

3.9 Post Closing Adjustment clause

3.9.1 The Ministry provided a post closing adjustment clause in the share purchase agreement (SPA) signed for the unlisted companies **(MFIL, BALCO, HTL** and **PPL)**. This was because the bidder submitted its bid based on the information as per the last audited balance sheet, while there might be accretion or depletion in the current assets/ current liabilities resulting in change in the net

[29] ***Arbitrage opportunity*** *is the opportunity to buy an asset at a low price and then immediately sell it on a different market for a higher price.*

working capital and the debt position as on the closing date[30] which was the date of purchase of shares by SP. As per the SPA, within 90 calendar days following the closing date, Government and SP were to jointly appoint an accounting firm to prepare and deliver to each of the parties a closing date statement showing the computation of current and non-current assets as well as current and non-current liabilities of the PSU in each case as on the closing date and the last balance sheet date. The payment was required to be settled between the parties within 45 calendar days from the date of delivery of the statement by the accounting firm to the parties. Accordingly, the SPAs of unlisted companies, namely **MFIL, BALCO, HTL** and **PPL** contained the specific clause indicating the mechanism for the settlement of dues on account of post closing adjustments. Provision for arbitration was also included in the SPA, in case of dispute.

3.9.2 Audit noted that in pursuance of the post closing adjustment clause in SPA, the strategic partners (SP) submitted their claims as indicated in Table 10, which were still under the consideration of Government (May 2006). In none of the four unlisted PSUs was there a situation where Government could have gained out of the operation of this clause which ended up being not only one sided and open ended but stood firmly in the way of a proper assessment of the actual outcome of disinvestment. In fact, **MFIL, HTL** and **PPL** stood referred to the Board for Industrial and Financial Restructuring (BIFR) after disinvestment. Particulars of the four unlisted PSUs that were disinvested are indicated in Table 10. The details of unsettled claims could not be examined as these were in different stages of processing by the respective administrative Ministries.

Table 10: Status of post closing adjustment claims as on May 2006

(Rs. in crore)

Sl.No.	Name of PSU	Amount realized through strategic sale	Amount claimed by SP	Amount accepted and paid by Government	Remarks
1.	**MFIL**	105.45	17.48	12.64	SP had claimed a further amount of Rs. 4.43 crore
2.	**BALCO**	551.50	16.72	Not settled	Government still examining the matter
3.	**HTL**	55	56.49	Not settled	-do-
4.	**PPL**	151.70	151.55	Not settled	-do-

3.9.2.1 MFIL: The appointed accounting firm had submitted a statement on 1 May 2000 which required Government to pay Rs. 17.48 crore to SP but Government accepted a claim amounting to Rs. 12.64 crore and released the

[30] ***Closing date*** *is the day on which closing (payment of the Purchase Price to the Government and the completion of the sale to and purchase by the Strategic Partner of the first tranche transaction shares in accordance with the terms of the agreements) occurs.*

payment of Rs. 10.94 crore in July 2000 and Rs. 1.70 crore in November 2000. SP however, had not given up the claim to the balance of Rs. 4.43 crore, which was stated to be still under the consideration of Government.

3.9.2.2 BALCO: The accounting firm initially computed the value of net assets as Rs. 478.08 crore as on 2 March 2001, which was not accepted by Government on ground of incorrect calculation of termination benefits like voluntary retirement liabilities, income tax provision and net income tax expenses. The amount was later revised to Rs. 558.17 crore as against the adjusted net asset value of Rs. 590.95 crore as on 31 March 2000. As there was a difference of Rs. 32.78 crore (Rs. 590.95 minus Rs. 558.17 crore) between the adjusted net assets value of 2 March 2001 and the net assets value of 31 March 2000, Rs. 16.72 crore (51 *per cent* of equity acquired by SP) became payable by Government to SP. The Ministry of Finance in their reply (May 2006) stated that the matter was still under the consideration of the Ministry of Mines.

3.9.2.3 HTL: Government and SP appointed the accounting firm in June 2002, who submitted the closing date statement in September 2002. As per the statement, net assets amount as on 16 October 2001 was computed as (-) Rs. 18.87 crore as against Rs. 57.46 crore as on 31 March 2001. Accordingly, SP submitted a claim for Rs. 56.49 crore in proportion to the shareholding acquired from Government, for payment. The Department of Telecommunication constituted a committee on 17 December 2002 to recommend the course of action to Government. On 30 May 2005, Department of Telecommunication intimated Audit that Government had not accepted the claims of SP and the issue was before the Arbitral Tribunal.

3.9.2.4 PPL: The accounting firm computed the amount of total deterioration in net assets between 1 April 2001 and 28 February 2002 to be Rs. 204.80 crore. SP, thereafter submitted (December 2002) a claim of Rs. 151.55 crore representing 74 *per cent* of the difference in net asset value between the last balance sheet date and the closing date. The Department of Fertilizers (DOF) got the statement prepared by the accounting firm examined by GA based on whose recommendation the claim of Rs. 151.55 crore was to be reduced to Rs. 125.67 crore, which was not accepted by SP. Thereafter DOF appointed the statutory auditor of PPL before disinvestment, to examine the accounts of PPL with reference to the report of the accounting firm. The statutory auditor intimated that Rs. 86.96 crore would be payable towards the post-closure claim. DOF was still (May 2006) examining the matter in view of the significant differences in the amounts calculated by three firms/auditors, as reconciliation was not possible without the concurrence of SP. The Ministry of Finance intimated to Audit (May 2006) that Government and SP had appointed a fourth auditor who had since submitted its report, which was stated to be under examination in DOF.

Audit noted that Government implemented two limited financial restructuring packages with the objective of preventing PPL from coming under the purview of BIFR. On all the occasions, accumulative losses had almost wiped out the net

worth[31] of the PSU. By implementing the limited packages, the core issue of turning around the performance of PPL was not addressed properly and the limited implementation packages failed to revive the PSU, which defeated the very purpose of the restructuring strategy.

The financial performance of the PSU deteriorated and it recorded provisional losses of Rs. 120 crore during 2001-02, which could be claimed by SP under the shareholders agreement. Audit noted that Government had received a claim from SP of Rs. 151.55 crore under the post closing adjustment clause of SHA against the receipt of Rs. 151.70 crore on account of disinvestment of 74 *per cent* equity. Ultimately, as of May 2006, Government was saddled with the demand from SP which had the potential of wiping off almost the entire realization from disinvestment and there was the prospect of Government possibly ending up transferring the PSU to SP by paying the latter instead of receiving proceeds from the sale.

3.9.3 It would not be possible to assess the effective outcome of each case of disinvestment especially of unlisted PSUs unless the total picture emerged as a consequence of the settlement of dues to the satisfaction of Government and SP following the terms of the SPA. In the case of listed PSUs to be disinvested, Government needed to safeguard its interests adequately against any claims on account of alleged non-disclosure or inadequate disclosure before or during the process of disinvestment that could be raised by SP subsequent to the disinvestment. There was also a mechanism required to be instituted to ensure that the Ministry which had executed the process of disinvestment had regular flow of information on the extent of technology and finances that SP had actually brought in to improve the performance of the PSU as a going concern after the disinvestment. In short, it would be a good practice for the process of disinvestment if the DOD did not consider its mission accomplished merely with the transfer of the immediate stake on sale under the process and was entrusted with the responsibility of assessing the full and complete outcome of the disinvestment exercise carried out.

3.10 The case of IPCL

Government had realized sale proceeds amounting to Rs. 1490.84 crore in May 2002 and SP had submitted claims amounting to Rs. 927.41 crore on account of alleged non-disclosure of certain factual matters in the financial statements or in the due diligence process. The Ministry of Finance in their reply (May 2006) stated that GA was appointed by the PSU/Department of Chemicals and Petrochemicals who had also set up data room for due diligence. The Department of Chemicals and Petrochemicals intimated Audit in May 2006 that these claims were under examination by a High Power Committee.

3.10.1 This was yet another instance where Government was saddled with a substantial claim from SP after the conclusion of disinvestment of the approved

---

[31] ***Net worth*** *is the difference between the total assets and the total liabilities of a company and is also called shareholders' equity or net assets.*

stake apart from four instances of unlisted PSUs mentioned in paragraph **3.9.2** above. The claim of SP in the case of IPCL was more serious as it was based on grounds of non disclosure of relevant information in the financial statements or even in the due diligence process of disinvestment. The fact that the matter was engaging the attention of a specially constituted High Power Committee of Government indicated that there were deficiencies, which did not make the procedure of disinvestment robust enough and ab initio prevent such claims from being raised by SP after disinvesment. This also brings into question the competency of GA and the legal advisor in this case who ought to have helped ensure through their inputs and advice that the situation like the present one never arose in the first place. The Ministry's reply indicating that the responsibility for the situation did not lie with them but with the administrative Ministry also pointed to the absence of a clear accountability mechanism in the approval process of disinvestment besides highlighting deficiency in documentation.

3.11 Cost of sale

3.11.1 Government had incurred expenditure on account of fees to GA and other intermediaries (Asset Valuer, Legal Advisor, Chartered Accountant, Accounting Consultants, Environmental Consultants, Mining Experts, Public Relation Agency, etc.) in addition to the cost incurred on publicity. Audit noted that the cost of sale amounted to **Rs. 2.66 crore** (excluding expenditure on advertisement and payment to asset valuer) for **MFIL**, **Rs. 7.19 crore** for **BALCO, Rs. 0.82 crore** for **HTL, Rs. 0.73 crore** for **CMC, Rs. 3.68 crore** (excluding the expenditure incurred on publicity) for **VSNL, Rs. 8.20 crore** (excluding the expenditure incurred on publicity, taxes and out of pocket expenses paid to other intermediaries) for **IBP** and **Rs. 74.85 lakh** (excluding the expenditure incurred on publicity) for **PPL, Rs. 4.57 crore** for **HZL** and **Rs. 11.18 crore** on the fees of GA (excluding the payment made to intermediaries and other agencies) for **IPCL.** The cost of sale of each of the nine PSUs would have to be viewed against the background that documentation in support of the quality and completeness of the work of the advisors was neither adequate nor always available with the Ministry and that the process threw up substantial post disinvestment claims ostensibly under the SHA/SPA despite the engagement of reputed experts and advisors who could not be held accountable for any possible deficiencies on their part. There was a more serious deficiency in the case of **IPCL** as mentioned in paragraph **3.10** where the responsibility or inadequate or deficient advice and assistance of the advisors could be called into question.

3.12 Delay in creation of disinvestment fund

Audit noted that Government in the budget for 2000-2001, had echoed the recommendation of the Disinvestment Commission that the proceeds from disinvestment be placed separately in a disinvestment fund so that these were not fungible with other government receipts. However, it was only in January 2005 that Government finally decided to constitute a National Investment Fund, which was yet to be operationalised (May 2006). As a result, receipts realized on account of strategic sale of nine PSUs were accounted for as capital receipts in

the Consolidated Fund of India and there was no mechanism with the Ministry to monitor and ensure its utilization for the identified or declared purpose. The Ministry of Finance in their reply (May 2006) stated that the National Investment Fund had since been established. The unusual delay in crediting the proceeds realized from disinvestment of nine PSUs examined in this report deprived the Ministry and the DOD of a valuable mechanism that would have enabled monitoring and ensuring the use of the proceeds only for the achievement of the primary objectives of disinvestment as laid down in the manual of procedure and the policy of disinvestment of May 2001. This would have served to ensure that the proceeds were not diverted to reducing the fiscal deficit.

Recommendation

- *The Ministry may ensure that the National Investment Fund is operationalized promptly so that sale proceeds realized from future disinvestments are credited into the Fund which would enable effective monitoring of the end use of the funds and proper assessment of the achievement of the objectives of disinvestment.*
- *The Ministry may also put in place a mechanism to ensure that the advisors and intermediaries do not remain insulated from any responsibility for any post disinvestment claims. A suitable indemnity clause in the agreements with the advisors could be considered for this purpose.*
- *The Ministry may critically examine the efficacy of the post closure adjustment clause in SPA especially in the case of unlisted PSUs as the clause would appear to have put Government in the position having to grapple with substantial claims raised by SPs in each of the four unlisted disinvested PSUs.*

Conclusion

The examination of the process of disinvestment as implemented in the nine selected PSUs brought out several areas where good practices needed to be instituted and some of the extant practices required refinement and strengthening. The Global Advisors needed to be bound in a more effective manner through transparent agreements monitored regularly. There was a need to critically review the efficacy of the post closing adjustment clause in the share purchase agreement in the case of unlisted PSUs so that Government was not exposed to uncertainty and protracted litigation after disinvestment. Each major assumption behind the crucial factors affecting valuation of the PSU needed to be justified in a transparent manner. Essential preparatory work to disinvestment such as ensuring clear titles to all fixed assets and pre- disinvestment restructuring wherever warranted would need to be completed before calling for expressions of interest. Instituting such better practices would have made the sale attractive to the prospective bidders and generated adequate competitive tension that would have automatically led to a better price for the stake on sale.

In short, Audit noted that the DOD had taken up the challenging task of disinvestment of nine PSUs with different backgrounds and diverse kinds of problems and had devised a strategy, which involved the complex exercises of valuation as well as making the sale as attractive as possible to the prospective buyers while keeping the interests of Government in view. Further improvements and refinement in the areas mentioned in this report, if carried out, are likely to make the process robust and more transparent and productive so that Government could obtain the maximum value for the stake under sale without exposing itself to uncertainties and risks of litigation afterwards.

New Delhi
Dated : 17 August 2006

(K.R. SRIRAM)
Principal Director of Audit,
Economic & Service Ministries

Countersigned