

CHAPTER I: INTRODUCTION

1.1 Profile of the audited entities

This report relates to matters arising from the audit of financial transactions of the following organisations under the Ministry of Defence:

- Army,
- Inter Services Organisations,
- Defence Research and Development Organisation and its laboratories dedicated primarily to Army and Ordnance Factories,
- Defence Accounts Department
- Ordnance Factories, and
- Defence Public Sector Undertakings

Ministry of Defence, at the apex level, frames policies on all Defence related matters. It is divided into four departments, namely, Department of Defence, Department of Defence Production, Department of Research and Development and Department of Ex-Servicemen Welfare. Each department is headed by a Secretary. The Defence Secretary who is the Head of the Department of Defence also coordinates the activities of other departments.

Indian Army is mandated to safeguard National Interests from External Aggression and Internal Subversion. Army is primarily responsible for the Defence of the country against external aggression and safeguarding the territorial integrity of the nation. It also renders aid to the civil authorities at the time of natural calamities and internal disturbances. It is, therefore, incumbent upon the Army to suitably equip, modernize and train itself to meet these challenges

The Inter Services Organisations, such as Armed Forces Medical Services, Military Engineer Services (MES), Defence Estates, Quality Assurance, *etc.*, serve the Defence forces in the three wings of the Army, Navy and Air Force. They are responsible for development and maintenance of common resources for optimising cost-effective services. They function directly under Ministry of Defence.

Defence Research & Development Organisation (DRDO) works under Department of Defence Research and Development of Ministry of Defence. DRDO dedicatedly working towards enhancing self-reliance in Defence Systems and undertakes design & development leading to production of world class weapon systems and equipment in accordance with the expressed needs and the qualitative requirements laid down by the three services. DRDO,

through its chain of laboratories, is engaged in research and development, primarily to promote self-reliance in Indian Defence sector. It undertakes research and development in areas like aeronautics, armaments, combat vehicles, electronics, instrumentation, engineering systems, missiles, materials, naval systems, advanced computing, simulation and life sciences.

Ordnance Factory Board (OFB) functions under the administrative control of the Department of Defence Production and is headed by Director General, Ordnance Factories. Thirty-nine factories are responsible for production and supply of ordnance stores to the armed forces.

Defence Public Sector Undertakings (DPSUs) function under the administrative control of Department of Defence Production. There are nine DPSUs which are headed by respective Chairman cum Managing Director (CMD).

1.2 Authority for audit

The authority for our audit is derived from Articles 149 and 151 of the Constitution of India and the Comptroller and Auditor General's (Duties, Powers and Conditions of Service) (DPC) Act, 1971. We conduct audit of Ministries/Departments of the Government of India under Section 13 of the CAG's (DPC) Act. Major Cantonment Boards are audited under Section 14 of the said Act. Principles and methodology of compliance audit are prescribed in the "Regulations of Audit and Accounts, 2007".

1.3 Audit methodology and procedure

Audit is prioritised through an analysis and evaluation of risks so as to assess their criticality in key operating units. Expenditure incurred, operational significance, past audit results and strength of internal control are amongst the main factors which determine the severity of the risks. An annual audit plan is formulated to conduct audit on the basis of risk assessment.

Audit findings of an audited entity are communicated through Local Test Audit Reports/Statement of Cases. The response from the audited entity is considered which may result in either settlement of the audit observation or referral to the next audit cycle for compliance. Serious irregularities are processed as draft paragraphs for inclusion in the Audit Reports which are submitted to the President of India under Article 151 of the Constitution of India, for laying them before each House of Parliament. Performance Audits are done through structured exercise by defining scope of audit, holding entry conference, sampling of units, exit conference, inclusion of feedback on draft report and issuance of final report.

1.4 Structure of the Report

This report contains eight chapters comprising three performance reviews and 20 audit paragraphs based on the audit of financial transactions of Ministry of Defence pertaining to Army, Inter Services Organisations, Defence Research and Development Organisation, Defence Accounts Department, Ordnance Factories and DPSUs.

1.5 Financial aspects and Budgetary Management

1.5.1 Introduction

The budgetary allocations of the Ministry of Defence are contained under eight Demands for Grants of which six grants are included under Defence Service Estimates (DSE) and two under Civil Grants.

- Two Civil Grants which include Demand No. 20 - Ministry of Defence (Civil) and Demand No. 21 - Defence Pensions.
- Six Grants of the Ministry of Defence, which include the following:
 - Demand No.22, Defence Services - Army
 - Demand No. 23, Defence Services - Navy
 - Demand No. 24, Defence Services - Air Force
 - Demand No. 25, Defence Ordnance Factories
 - Demand No. 26, Defence Services - Research & Development
 - Demand No. 27, Capital Outlay on Defence Services -Includes All Services and Departments other than those covered by the Demands for Grants of Ministry of Defence (Civil)
- The budgetary requirements for the Border Roads Organisation are provided by the Ministry of Road Transport & Highways.

The above mentioned Grants are broadly categorized into Revenue and Capital expenditure.

- **Revenue Expenditure:** This includes expenditure on Pay & Allowances, Transportation, Revenue Stores (like Ordnance stores, supplies by Ordnance Factories, Rations, Petrol, Oil and Lubricants, Spares, *etc.*), Revenue Works (which include maintenance of Buildings, water and electricity charges, rents, rates and taxes, *etc.*) and other miscellaneous expenditure.
- **Capital Expenditure:** This includes expenditure on Land, Acquisition of new weapon and ammunitions, Modernization of Services,

Construction Works, Plant and Machinery, Equipment, Tanks, Naval Vessels, Aircraft and Aero-engines, Dockyards, etc.

Approval of Parliament¹ is taken for the Gross expenditure provision under different Demands for Grants. Receipts and Recoveries, which include items like sale proceeds of surplus/obsolete stores, receipts on account of services rendered to State Governments/other Ministries, etc. and other miscellaneous items are deducted from the gross expenditure to arrive at the net expenditure on Defence Services for the six Demands, viz. Demands Nos. 22 to 27. A brief analysis of these grants is given below except Grant No. 23, Defence Services-Navy and Grant No.24, Defence Services-Air Force which are commented upon in a separate report.

1.5.2 Grant No.20 & 21- Expenditure from Civil Grants

1.5.2.1 Grant No. 20- Expenditure of Ministry of Defence (Civil)

Against the revised estimates of ₹19,467 crore actual expenditure for the year 2014-15 under Demand No. 20 was ₹19,363 crore. This included expenditure of ₹18,175 crore under Revenue heads and ₹1,188 crore under Capital head. Major components of these expenditures are shown in the **Table-1**:

Table -1: Table showing major components of Revenue and Capital expenditure

Revenue Expenditure		Capital Expenditure	
Name of Department	₹ in crore	Name of Department	₹ in crore
Canteen Stores Departments (CSD)	14199	Customs-CGO	1142
Defence Accounts Department (DAD)	1136	DEO-Other Building	24
Coast Guard Organisation (CGO)	1287	DAD-Other Building	17
Jammu & Kashmir Light Infantry (JAK LI)	969	Misc. loans for Unit Run Canteen (URC) by CSD	2
Defence Estate Organisation (DEO)	390	Other Departments	3
Other Departments	194		

1.5.2.2 Grant No. 21 - Defence Pensions

Defence Pensions, under Ministry of Defence, provides for pensionary charges in respect of retired Defence personnel (including Defence Civilian employees) of the three services, viz. Army, Navy and Air Force, and of employees of Ordnance Factories, etc. It covers payments of service pension, gratuity, family pension, disability pension, commuted value of pension, leave encashment, etc.

¹ Report No.20 of Standing Committee on Defence (2012-13, Fifteenth Lok Sabha)

The position of budgetary allocation and expenditure for the year 2014-15 under this Grant is as under:

Table- 2: Budgetary allocation and Actual Expenditure

(₹ in crore)

Budget Estimates	Revised Estimates	Actual Expenditure
51,000	50,000	60,450

The excess expenditure of ₹10,450 crore over the revised estimates underlines the need for improvement in the budget estimation.

1.6 Grant No. 22 to 27 – Defence Services Estimates

1.6.1 At a glance

The overall Defence Budget (Grant No. 22 to 27) allocation and actual expenditure (Voted & Charged) for the period 2010-11 to 2014-15 are given in **Table-3**.

Table-3: Total Defence Budget allocation and Actual expenditure

(₹ in crore)

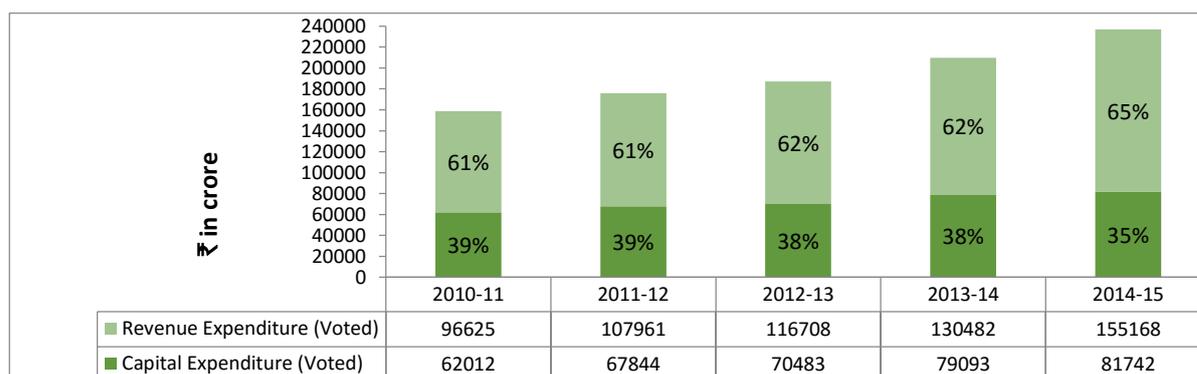
Year	Budget Provision	Actual Expenditure
2010-11	1,56,127	1,58,723
2011-12	1,78,891	1,75,898
2012-13	1,98,526	1,87,469
2013-14	2,17,649	2,09,789
2014-15	2,54,000	2,37,394

The data relating to actual Defence expenditure in 2014-15 shows an increase of 13.16 per cent over the previous year and overall increase of 49.56 per cent since 2010-11.

1.6.2 Revenue expenditure vs. Capital expenditure in Defence Services

Capital and Revenue expenditure (voted) for the period 2010-11 to 2014-15 is given in **Chart - 1** below:

Chart - 1: Revenue expenditure vs. Capital expenditure (Voted)



The above data shows that the proportion of Voted Capital and Revenue expenditure as a percentage of total Defence expenditure (voted) has remained between 35 and 39 *per cent* during the period 2010-11 to 2014-15, however, there is an increase of three *per cent* in revenue expenditure over the previous year in 2014-15 and a corresponding decrease in the Capital expenditure.

1.7 Break-up of Expenditure (voted) relating to Army, Ordnance Factories & R&D (Capital & Revenue) – Grant No. 22, 25, 26 and 27²

A detailed analysis of the expenditure (voted) for the period 2010-11 to 2014-15 relating to Army, Ordnance Factories and R & D showing Revenue and Capital expenditure is given in **Table-4** below.

Table-4: Expenditure (voted) of Army, Ordnance Factories & R&D

(₹ in crore)

Description of Grant	Components of Expenditure	Year				
		2010-11	2011-12	2012-13	2013-14	2014-15
Army	Actual	80,790	86,776	94,274	1,02,139	1,17,700
	Revenue	65,002 (80.46)	71,833 (82.78)	79,517 (84.35)	87,720 (85.88)	99,139 (84.23)
	Capital	15,788 (19.54)	14,943 (17.22)	14,757 (15.65)	14,419 (14.12)	18,561 (15.77)
Ordnance Factory	Actual	1,527	1,704	2,116	3,964	13,576
	Revenue	1,073 (70.30)	1,428 (83.79)	1,754 (82.88)	3,499 (88.26)	12,830 (94.50)
	Capital	454 (29.70)	276 (16.21)	349 (16.60)	465 (11.74)	746 (5.50)
R&D	Actual	1,0192	9,932	9,860	10,929	13,635
	Revenue	5,231 (51.32)	5,321 (53.58)	5,218 (52.92)	5,696 (52.12)	6,236 (45.74)
	Capital	4,961 (48.68)	4,611 (46.43)	4,642 (47.08)	5,233 (47.88)	7,399 (54.26)

Note: Figure in the brackets represents the Revenue/Capital expenditure as a percentage of the total Actual expenditure

- The total Army expenditure during 2014-15 has registered an increase of 15.24 *per cent* over the previous year with the Revenue expenditure

² Grant No. 23 – Navy and Grant No. 24 – Air Force are analysed in the respective Audit Reports of the Union Government (Defence Services) Air Force and Navy

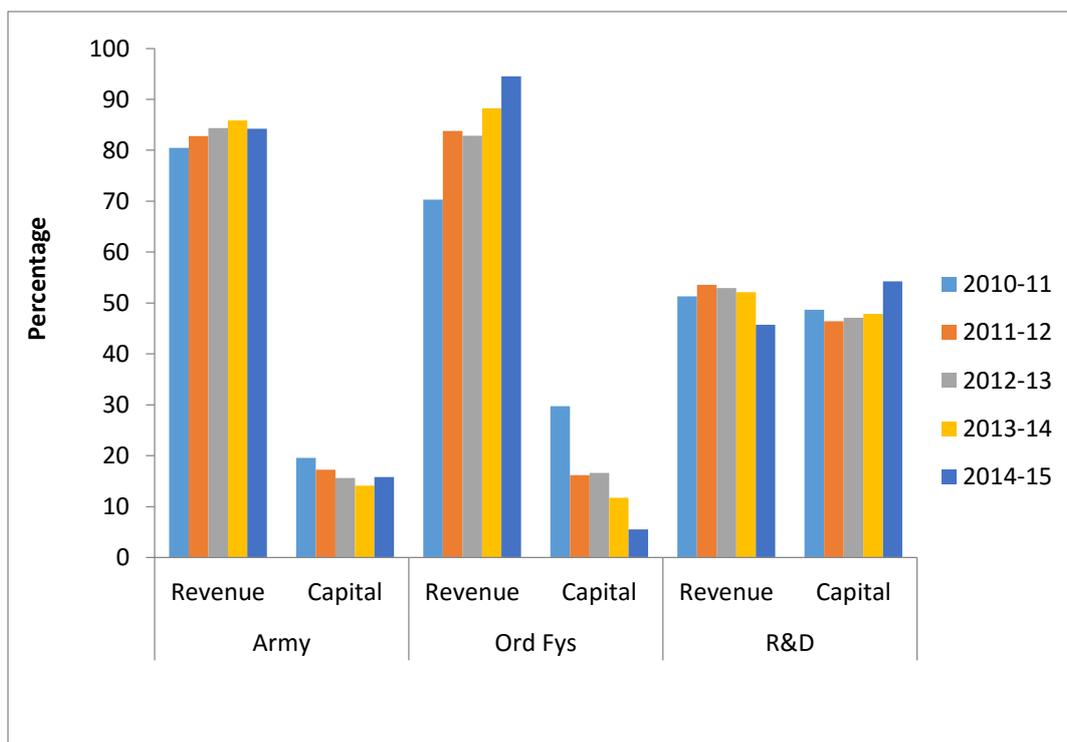
registering an increase of 13.02 *per cent* and the Capital expenditure recording an increase of 28.73 *per cent*. Since 2010-11, the components of expenditure have increased by 45.68 *per cent*, 52.51 *per cent* and 17.56 *per cent* respectively.

- The increase in the expenditure of Ordnance Factory (OF) Board during 2014-15, as depicted in the Table 4 above, was mainly due to change in the accounting system where the approval of Parliament was sought on "gross" amounts of expenditure. During the previous years the approval was however being sought on 'Net Basis of accounting'
- The total R&D expenditure during 2014-15, has recorded an increase of 24.76 *per cent* over the previous year with Revenue expenditure an increase of 9.48 *per cent* and the Capital expenditure registering an increase of 41.38 *per cent*. Since 2010-11, the components of expenditure have increased by 33.78 *per cent*, 19.22 *per cent* and 49.14 *per cent* respectively.

1.7.1 Trend of total Expenditure in respect of Army, Ordnance Factories and Research & Development - Capital and Revenue

A trend of total Army, Ordnance Factories and Research and Development expenditure both Capital and Revenue as a proportion of actual expenditure during the period 2010-11 to 2014-15 is given in **Chart-2** below:

Chart-2: Trend Revenue and Capital Expenditure as a percentage of the total expenditure



- **Army:** In 2014-15 Revenue component of total Army expenditure has increased by 4 *per cent* since 2010-11 from 80 *per cent* in 2010-11 to 84 *per cent* in 2014-15 while the Capital component has recorded a corresponding decrease during the same period from 20 *per cent* (2010-11) to 16 *per cent* (2014-15).
- **Ordnance Factories:** The Revenue and Capital component of the expenditure by the Ordnance Factories for the period 2010-11 to 2014-15 shows a consistent increase. The figures for the year 2014-15 depicted in the Table 4 above also factors in the change in the accounting system, from 'Net Basis of accounting' to 'Gross Basis of accounting'.
- **Research & Development:** The Revenue expenditure on Research & Development has decreased by five *per cent* from 51 *per cent* in 2010-11 to 46 *per cent* in 2014-15 during the period 2010-11 to 2014-15 while the Capital expenditure has increased by a similar percentage from 49 *per cent* to 54 *per cent*.

1.8 Trend of major components of Revenue expenditure (Voted)

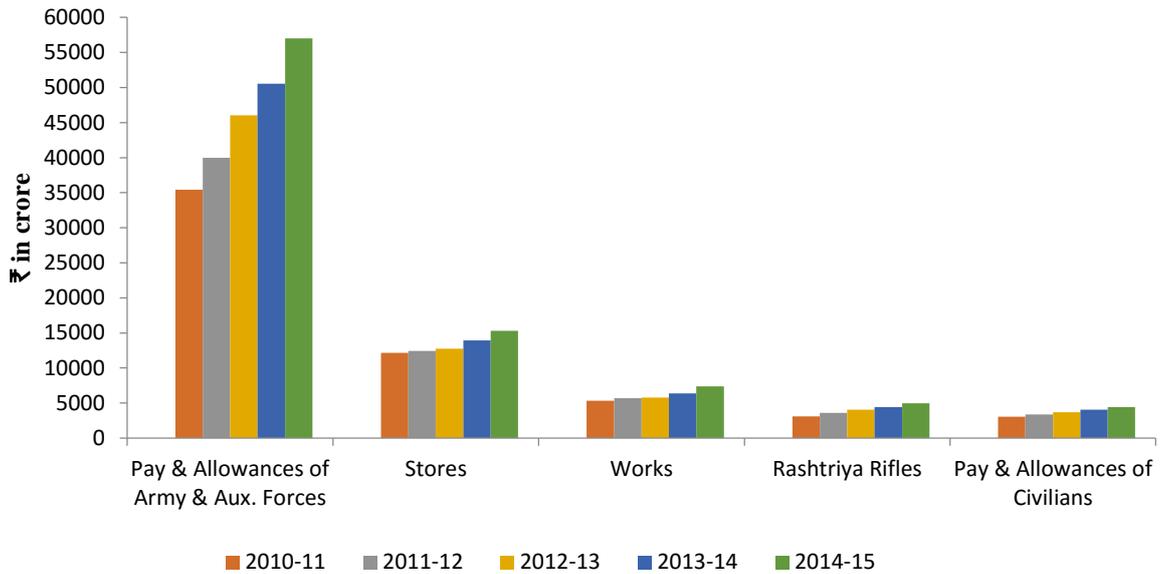
1.8.1 Army (Voted)

During the period 2010-11 to 2014-15 maximum Revenue expenditure was incurred under five Minor Heads (MH) of the Army as given in **Table-5** and in the **Chart-3** below:

Table-5: Details of major components of Revenue expenditure of Army

(₹ in crore)

Components of Expenditure	Year				
	2010-11	2011-12	2012-13	2013-14	2014-15
Pay & Allowances (MH-101& 103)	35,445	39,996	46,057	50,533	56,997
Stores (MH-110)	12,144	12,442	12,750	13,954	15,324
Works (MH-111)	5,308	5,709	5,769	6,384	7,399
Rashtriya Rifles (MH-112)	3,099	3,585	4,076	4,436	4,967
Pay & allow. of Civilians (MH-104)	3,051	3,361	3,674	4,056	4,422

Chart-3: Major components of Revenue expenditure of Army

- Against a 13 *per cent* annual increase in the revenue expenditure of Army in 2014-15, overall increase in five Minor Heads having highest expenditure *viz.* Pay & Allowances of Army & Auxiliary Forces, Stores, Works, Rashtriya Rifles and Pay and Allowances of Civilian ranged between 9 and 16 *per cent*.

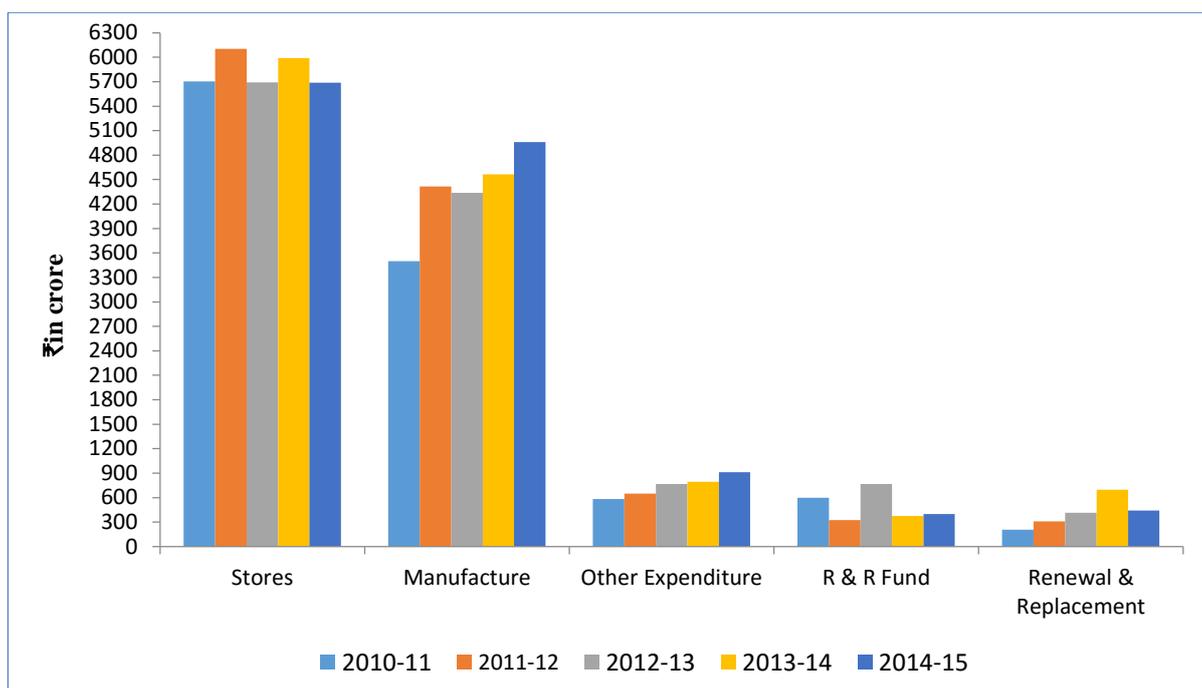
1.8.2 Ordnance Factories (voted)

During the period 2010-11 to 2014-15 maximum Revenue expenditure was incurred under five MH of the Ordnance Factories as shown in **Table-6** and in the **Chart-4** below:

Table-6: Major components of Revenue expenditure of Ordnance Factories

(₹ in crore)

Components of Expenditure	Year				
	2010-11	2011-12	2012-13	2013-14	2014-15
Stores MH-110	5,705	6,101	5,692	5,990	5,686
Manufacture- MH-054	3,500	4,415	4,336	4,563	4,961
Renewal & Reserve (R&R) Fund MH-797	600	325	350	375	400
Renewal & Replacement MH-106	208	310	416	697	442
Other expenditure MH-800	583	650	768	795	911

Chart 4: Major components of Revenue expenditure of Ordnance Factories**1.8.3 Research & Development (voted)**

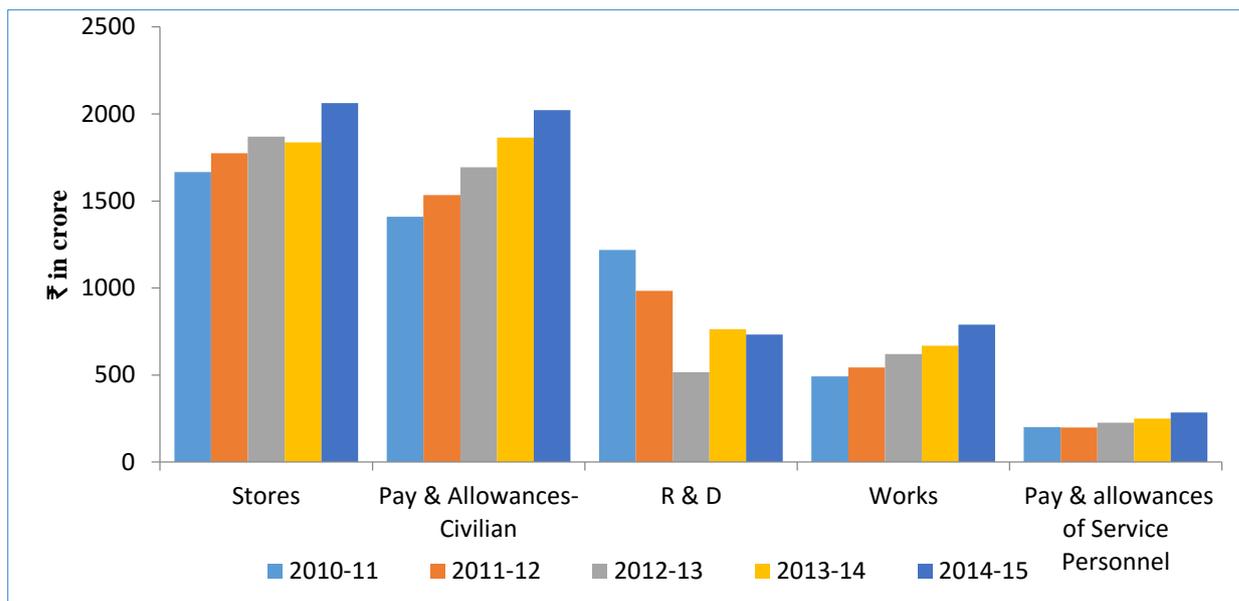
During the period 2010-11 to 2014-15 maximum Revenue expenditure was incurred under five Minor Heads (MH) of the R&D as given in **Table-7** and **Chart-5** below:

Table-7: Major components of Revenue expenditure of Research & Development

(₹ in crore)

Components of Expenditure	Year				
	2010-11	2011-12	2012-13	2013-14	2014-15
Stores MH-110	1,666	1,774	1,870	1,837	2,063
Pay & Allowances- Civilian MH-102	1,410	1,535	1,694	1,865	2,021
R&D MH-004	1,218	984	517	765	733
Works MH-111	492	543	621	669	790
Pay & Allowances of Service Personnel MH-101	202	198	226	251	285

Chart 5: Major components of Revenue expenditure of Research & Development



- Against an overall annual increase of 9.5 percent in the revenue expenditure of R&D in 2014-15, the increase in four Minor Heads having highest expenditure viz. Stores, Pay & Allowances of Civilians, Works and Pay & Allowances of Service ranged between 8 and 18 percent. However, in case of Minor Head R&D, there was a decrease of 4 percent over the previous year.

1.9 Trend of Capital expenditure - Major Head-4076-Grant No. 27- Capital Outlay on Defence Services

1.9.1 Components of Capital expenditure

There are eight Sub Major Heads (SMH) under this Grant, viz. Sub Major Head 01- Army, Sub Major Head 02 - Navy, Sub Major Head 03- Air Force, Sub Major Head 04 - Ordnance Factories, Sub Major Head 05 - R&D, Sub Major Head 06 - Inspection Organisation, Sub Major Head 07 - Special Metal and Super Alloys Projects and Sub Major Head 08- Technology Development.

1.9.2 Trend analysis of Capital expenditure³ (voted) of Army, Ordnance Factories and R&D

The details of Capital expenditure of Army, Ordnance Factories and R&D during the period 2010-11 to 2014-15 are given in **Table-8** below:

³ SMH- 02 and SMH- 03 are analysed separately in the respective Audit Reports of Union Government (Defence Services) of Navy and Air Force. In respect of SMH- 06 and SMH- 08 total expenditure for the period 2010-11 to 2014-15 was ₹44 crore and ₹140 crore respectively. In respect of SMH-07 the expenditure during these years was Nil.

Table-8: Total Capital Expenditure (Defence Services) Vs Army, Ordnance Factories and R&D

(₹in crore)

Capital Expenditure	Year				
	2010-11	2011-12	2012-13	2013-14	2014-15
Defence Services	62,012	67,844	70,483	79,093	81,742
Army	15,788	14,943	14,757	14,419	18,561
Ordnance Factories	454	276	349	465	746
Research & Development	4,961	4,611	4,642	5,233	7,399

- **Capital Expenditure of Defence Services:** Capital expenditure of Defence Services has recorded an increase of 3.35 *per cent* in 2014-15 over the previous year. In case of Army, OF and R&D the annual increase was however 29, 60 and 41 *per cent* respectively. For the five year period from 2010-11 to 2014-15 against the overall increase 32 *per cent* in the capital expenditure of Defence Services, the increase expenditure under Army, OF and R&D was 18, 65 and 49 *per cent* respectively.

1.10 Response of the Ministry/Department to Draft Audit Paragraphs

On the recommendations of the Public Accounts Committee, Ministry of Finance (Department of Expenditure) issued directions to all Ministries in June 1960 to send their response to the Draft Audit Paragraphs proposed for inclusion in the Report of the Comptroller and Auditor General of India within six weeks.

The Draft Paragraphs are forwarded to the Secretaries of the Ministry/ departments concerned drawing their attention to the audit findings and requesting them to send their response within six weeks. It is brought to their personal attention that in view of likely inclusion of such Paragraphs in the Audit Reports of the Comptroller and Auditor General of India, which are placed before Parliament, it would be desirable to include their comments in the matter.

Draft paragraphs proposed for inclusion in this Report were forwarded to the Secretaries concerned between December 2015 and February 2016 through letters addressed to them personally.

The Ministry of Defence did not send replies (March 2016) to 17 paragraphs out of 23 Paragraphs featured in Chapters II to VIII.

1.11 Action taken on earlier Audit Paragraphs

With a view to enforcing accountability of the Executive in respect of all issues dealt with in various Audit Reports, the Public Accounts Committee desired that Action Taken Notes (ATNs) on all paragraphs pertaining to the Audit Reports for the year ended 31 March 1996 onwards be submitted to them duly vetted by Audit within four months from the date of laying of the Reports in Parliament.

Review of ATNs relating to the Army as of March 2016 indicated that ATNs on 50 paragraphs included in the Audit Reports up to and for the year ended March 2013 and Report No.19 of 2015 remained outstanding, of which the Ministry had not submitted even the initial ATNs in respect of 9 Paragraphs and 11 ATNs (Sl. No.1 to 11) are outstanding for more than 10 years as shown in **Annexure-I**.