

Chapter I: Introduction

1.1 Background of the Special Audit

In June 2009, Ministry of Defence Department of Defence Production informed the Comptroller & Auditor General of India (CAG) that a case had been registered by Central Bureau of Investigation (CBI) against Shri Sudipta Ghosh, the former Director General Ordnance Factories involving serious charges of corrupt practices. CBI had requested the Ministry to examine whether there were irregularities in the procurement cases finalized during the tenure of the former DGOF. Ministry informed CAG that a proper analysis of the procurement cases finalized during the above period would require in-depth examination and considerable professional skills. Secretary, Department of Defence Production¹ therefore requested that a special audit of all the procurement contracts during the tenure of the former DG may be conducted by a suitable team of officers from the Indian Audit & Accounts Department.

Averring that the matter of involvement of the former DG in corrupt practices needs to be examined by the investigative agencies through criminal investigation and the institution of the office of the CAG is neither empowered nor equipped to carry out investigations of forensic nature, CAG nevertheless authorised review of the procurements of stores and machineries by the OFB and Ordnance Factories as a follow up audit of the previous Audit Report No 19 of 2007 on OFB procurements. It was pointed out to the Ministry that the earlier Report had highlighted a number of serious irregularities in the procurement system of the Ordnance Factories but it was yet to take effective action on the recommendations made in the Audit Report to address the deficiencies in the OF procurement system.

Ordnance Factories together are the largest departmentalized manufacturing enterprise in the government sector. On one hand, the functioning of the Factories has to have the flexibility to respond to demands typical of a manufacturing industry and on the other it is controlled by the government rules and regulations. Such a

¹ Through this report, Ministry would denote Department of Defence Production, Ministry of Defence.

scale of manufacturing requires deft management of huge manpower, huge inventories and large scale procurement of services, raw materials and semi finished goods to maintain almost a punishing round-the-clock production schedule. Much of the materials procured by the Organization, because they need to meet the stringent specifications of Defence, are not widely available in the domestic market. The increasing technological complexities and demands for newer products require constant innovations in technology as well as industrial practices.

1.2 Organisation of Ordnance Factories

There are at present 39 Ordnance Factories at 24 different locations. Two more Factories are being set up at Nalanda in Bihar and Korwa in Uttar Pradesh. The existing Factories are engaged in manufacture of arms, ammunitions, equipment, armored vehicles and personnel carriers, clothing and general stores items. At the apex is the Ordnance Factory Board (OFB) headed by the DG, who is the Chairman of the Board. The Board comprises, in addition, two additional DGs and seven members. It controls the executive functions of the organization. Apart from the overall management of the Factories which includes laying down policies and procedures on the functioning of the Factories, it monitors receipt of orders from the Services and Para-Military Forces, determines annual targets for Factories and converts orders into extracts for the Factories to manufacture. It controls the budget and provides required resources to the Factories. The OFB functions under the administrative control of the Department of Defence Production of the Ministry of Defence.

The cost of production of thirty nine Ordnance Factories in 2006-07 was Rs 7957.53 crore. In 2007-08, it was Rs 9312.61 crore and in 2008-09, it stood at Rs 10610.40 crore.

1.3 Scope of audit and audit objective

A team of 19 officers conducted the audit between September 2009 and February 2010. It was conducted in Department of Defence Production, Ordnance Factory Board, Ordnance Equipment Group Headquarters, Kanpur, Armoured Vehicles Group Headquarters, Avadi and 18 Ordnance Factories. Though the audit covered procurement during the period from 2006-07 to 2008-09, in several cases in order to analyze current procurement decisions, decisions taken in earlier years were

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examined. Apart from examining files and documents in Ministry and OFB, 1291 supply orders valuing Rs 4434 crore were examined by the team during the audit of the Board and Factories.

For the purpose of audit and this report, the Factories audited have been put under four groups as follows:²

SI No	Group	Factories audited
1	Avadi	Heavy Vehicles Factory, Avadi (HVF); Ordnance Factory Medak (OFMK); Ordnance Factory, Trichi (OFT)
2.	Kirkee	Ammunition Factory Kirkee (AFK); High Explosive Factory, Kirkee (HEF); Ordnance Factory Dehu Road (OFDR), Ordnance Factory Ambernath (OFA)
3.	Kanpur	Ordnance Factory Kanpur (OFC); Small Arms Factory Kanpur (SAF); Ordnance Equipment Factory, Kanpur (OEFC); Ordnance Parachute Factory Kanpur (OPF), Ordnance Clothing Factory Shahjahanpur (OCFS); Opto Electronics Factory Dehradun (OLF);
4.	Jabalpur	Gun Carriage Factory, Jabalpur (GCF); Vehicle Factory, Jabalpur (VFJ); Ordnance Factory Khamaria (OFK); Ordnance Factory Ambajhari (OFAJ); Ordnance Factory, Chanda (OFCH);

The breakup of the supply orders audited, region-wise are:-

Table 1: Number of Supply Orders audited and their value

Group	Cases audited	Value of stores audited (Rs in crore)
Kirkee	424	1063
Jabalpur	352	1892
Kanpur	290	199
Avadi	225	1280
Total	1291	4434

² For ease of reading, on most of the occasions, the Factories have been in this report be referred to by their shortened names.

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The threshold value of supply orders taken up for examination in audit in different Factories was determined with reference to the volume of such orders in these Factories. All orders more than Rs 1 crore were selected in Avadi and Jabalpur group of Factories due to high number of orders in this category. In Kirkee group of Factories, the supply orders of more than Rs 10 lakh were selected for audit. In Kanpur group of Factories, the orders were selected using a computer aided tool, to identify erratic fluctuations in the rates of each item procured in the past three years.

During the three years from 2006-07 to 2008-09, 39 Ordnance Factories spent Rs 19,697 crore for procurement of stores and machineries. Out of this, 18 Factories selected for audit spent Rs. 10,299 crore.

The special audit was conducted to assess whether:

- The Internal control and monitoring system are in place both at MOD and OFB level to ensure timely procurement of quality stores and machinery in an efficient and economic manner;
- The policies and procedures on procurement were appropriate and adequate;
- The requirement of stores and machinery as assessed by the Ordnance Factories was realistic, based on their estimated needs to meet production targets;
- The orders for stores and machinery were finalized so as to ensure procurement from the right source, at the right price and in the right quantity;

1.4 Audit criteria

The audit criteria were adopted to evaluate procurement activities in the Ministry, OFB and 18 Factories were:

- General Financial Rules
- Material Management and Procurement Manual³
- Other orders issued by various authorities in Government of India including Central Vigilance Commission.

1.5 About this Report

This report is the results of audit of a large number of individual procurement cases approved by Ministry of Defence, OFB and officials of Ordnance Factories. It is

³ OFB has revised the MMPM in 2009. Since this audit concentrated on procurements from 2006 to 31 March 2009, the earlier version of MMPM published in 2005 has been referred to.

divided into three parts. Part I includes the procurement decisions taken at the level of Ministry of Defence, Department of Defence Production and Ordnance Factory Board. Part II covers the procurements made in the Factories. Because of delegation of financial powers several such cases were referred to OFB and the Ministry for approval. Such cases have been included in Part II as they related to procurement for specific Factories. Part III deals with the general control environment affecting the procurement actions at the levels of Ministry, OFB and Factories.

Ordnance Factories place supply orders in thousands every year. While reporting cases in this report, the aspect of materiality has been kept in mind. Such materiality has been decided not only on the monetary value of the individual procurement, but also on several other factors. These factors included prima facie evidence of serious abuse of procedures as laid down in the General Financial Rules, Manuals and other orders, acts of bad faith and possibilities of fraud.

The fact that a particular kind of infraction has been reported in one or two Factories does not suggest that such cases were absent in other Factories. It is recommended that Ministry should take this report as a comprehensive feedback and initiate reforms on a wider scale.

1.6 Recommendations

Normally, recommendations are made at the end of each topic, if applicable. However, in this report, 20 recommendations have been made at the end of the report as the topics are interrelated. In respect of cases which are under investigations, only audit observations have been reported. No recommendations in such cases have been made.

Ministry of Defence, Department of Defence Production accepted all the recommendations.

1.7 Acknowledgement

The Defence Secretary, Secretary, Department of Defence Production, DG, Members and officials of OFB, Senior General Managers/ General Managers and their officers and staff of all 18 Ordnance Factories had extended unstinted co-operation and courtesies during the audit which is gratefully acknowledged.