

Chapter-3

PROCUREMENT SYSTEM AND PROCEDURES

3.1 Procurement Policy

The Company formulated detailed Purchase procedures in 1964, which was modified from time to time. During the period under review, Purchase Procedures 1996 was being followed which was modified again in December 2009. This modified Purchase Procedure was being followed by the Company, though the Board of Directors of the Company was yet to approve it (December 2010). The Purchase Procedure is applicable to all the units except orders placed on sub-contractors, purchases made by Regional offices abroad and works contracts which are governed by separate procedures.

3.1.1 Inadequacies in the system of Procurement

A review of the Purchase Procedures followed in the Company during the period of review revealed the following inadequacies:


- (a) Though as per the Purchase Procedure 2009, the Company and its units were required to monitor the price trends of material and components regularly, Audit observed that the same was not being done.

The Management stated (December 2010) that mapping the data of price trends of the electronic components was not practical and useful as prices vary on a day to day basis.

Reply is to be viewed in the light of the fact that though daily fluctuation of prices is an acceptable reality in today's economy, price monitoring is still very essential as it serves as a benchmark for price negotiation, especially in the backdrop of the fact that major procurement is being done on one or two quotes.

The Ministry agreed (March 2011) with Audit and stressed that the Company must comply with the institutionalized procedure of monitoring the price trends.

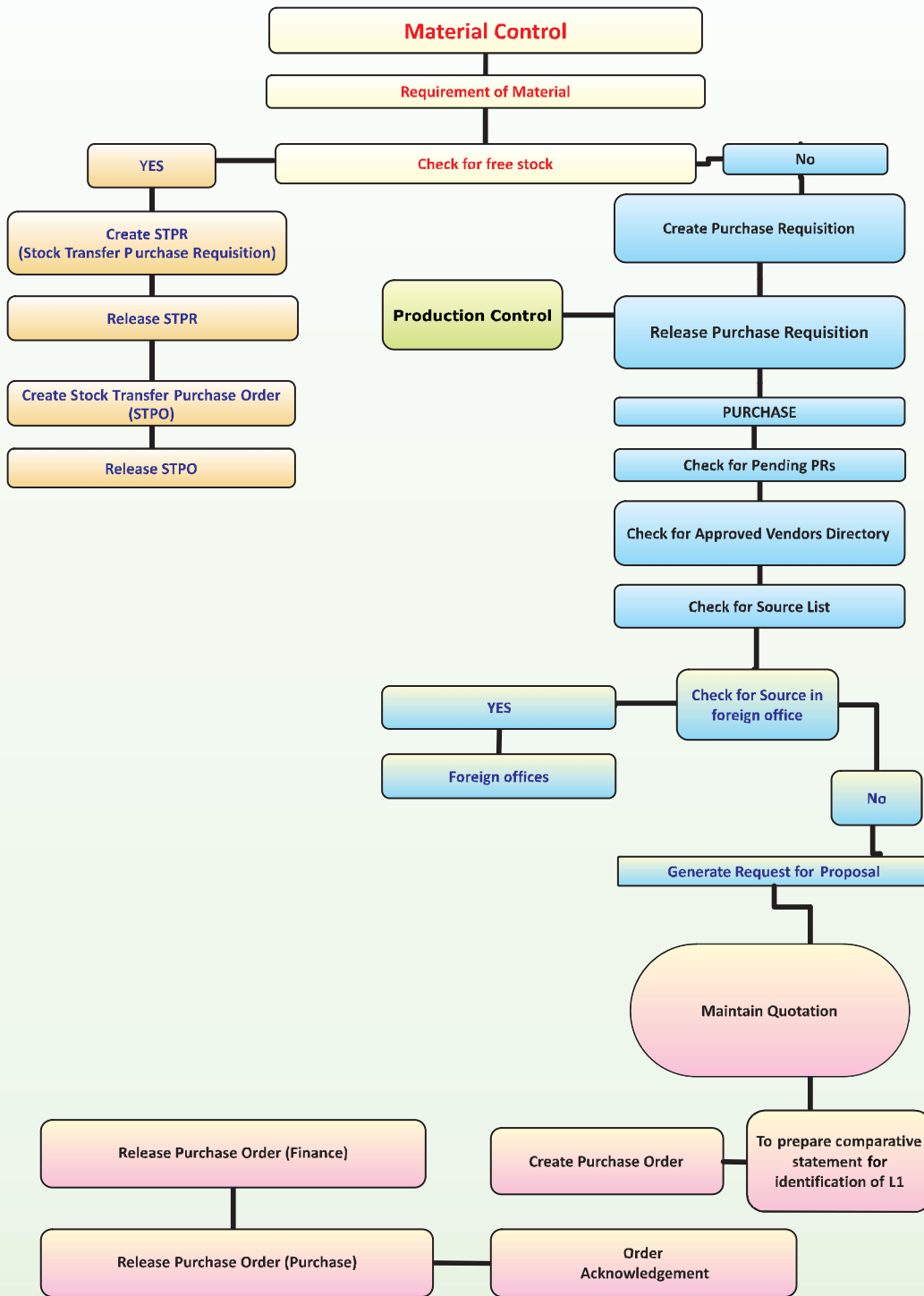
- (b) In terms of Purchase Procedure 1996, the Purchase Department was required to have at least two preferred suppliers of proven quality, price terms and delivery adherence and also a standby source with same qualities. However, while revising the Purchase Procedure in 2009, audit noticed that the said provision was removed which permitted the department to go for the single source without making efforts to develop alternate sources for obtaining competitive rates.



Further, even in cases where the Company had more than one approved vendor, the revised Purchase Procedure of 2009, permitted procurement through single tender with the approval of next higher authority.

The Management stated (December 2010) that the clause in the Purchase Procedure 1996 was not practical from vigilance angle as it stipulated splitting of order on preferred and standby supplier at the discretion of divisional / unit heads. On the issue of preferred suppliers, the Management replied that this was necessitated due to specified customer specifications in the agreements.

Flow chart indicating the Purchase Process



Rationale of this amendment is not justified as in the absence of this clause, the Company cannot fetch competitive rates by procuring material/ equipment from a single source which besides vitiating the sanctity of the procurement process, would also impact the profitability of the Company. Also, the guidelines of Central Vigilance Commission do not debar a Company to procure from more than one source provided the decision on the quantum of material was disclosed well in advance i.e. at the tender enquiry stage itself.

The Ministry stated (March 2011) that the company was being advised to relook the issues, deliberate in the Board meeting and also to obtain the Board approval for the modified Purchase Procedure 2009.

- (C) In case of purchase orders (POs) on foreign vendors, Purchase Procedure 1996 included a clause on Liquidated Damages (LD) with a ceiling of 10 per cent for belated supplies. However, as per Purchase Procedure 2009, this clause is applicable only when it is mutually agreed upon.

While admitting the fact, the Management stated (December 2010) that it was not possible to insist on the Company's terms and conditions on all the suppliers particularly in cases where the purchases are made on cash basis. The Management further added that by deleting the clause it had not foregone the right to claim LD.

The fact remains that in the absence of a specific clause on LD, the Company would not be able to legally enforce the recovery of LD even in cases where there had been a delay resulting in delayed supplies to the customers and imposition of LD against the Company.

The Ministry while agreeing (March 2011) with the audit, advised the Company to incorporate the relevant clause in all the POs placed on foreign vendors.

3.2 Under utilization of Overseas offices

The Company established two overseas regional offices (New York-1979, Singapore- 1998) for importing materials/components directly and thereby achieving a saving of 10 per cent on prices. Audit, however, observed that during the period 2007-08 to 2009-10, quantities imported through the overseas offices were very insignificant.

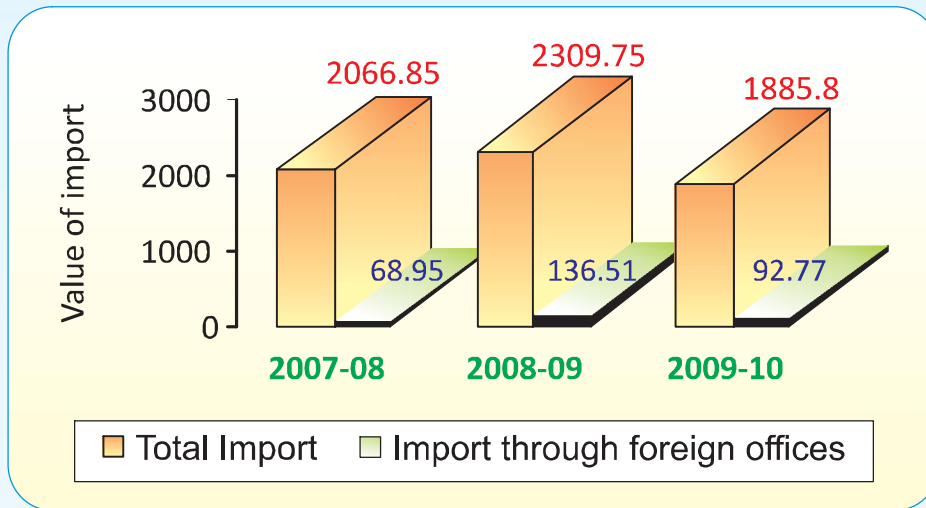
The table and graph below indicate the quantities and value of imports through these offices

Table 2

Value ₹ in crore

| | 2007-08 | | 2008-09 | | 2009-10 | |
|--|--------------|-------------|--------------|-------------|--------------|-------------|
| | No of POs | Value | No of POs | Value | No of POs | Value |
| Total imports | 14126 | 2066.85 | 22083 | 2309.75 | 21790 | 1885.80 |
| Import through foreign offices | 5856 | 68.95 | 6584 | 136.51 | 5241 | 92.77 |
| Share of Import through foreign offices (%) | 41.46 | 3.34 | 29.81 | 5.91 | 24.05 | 4.92 |

Share of import through overseas offices (value)



Thus it is evident that during the period under review, the services of the overseas offices were under utilized as meager quantities (4.76 per cent) of material worth ₹ 298.23 crore only, out of a total imports of ₹ 6262.40 crore were imported through these offices.

The Management stated (December 2010) that in many cases direct procurement is made from foreign sources after negotiating with the vendors or their authorized representatives in India.

However, Audit observed that a Committee constituted by the Company itself to study the economics of purchases reported (December 2002) that procurement through overseas offices was cheaper by 14 per cent in majority of cases. Further, the Committee had also recommended that such a study should be carried out after every three years to reassess the situation., .However, it appears that the Management did not give any cognizance to the recommendations of the committee.

The Ministry informed (March 2011) that the Company has been advised to reassess the requirement of its overseas offices.

3.3 Unit Procurement of components-Lack of synergy

Purchase Procedure 1996 and Purchase Procedure 2009 required Material control departments to ascertain the availability of components being manufactured in-house by other sister unit(s) before procuring the same from outside source. However, Audit observed that the Company procured components/manufactured parts valuing ₹ 355.27 crore (46 POs) from outside sources though the components were, being manufactured in the sister units, without ascertaining the availability from these units.

A further audit analysis through SAP of total procurement made during 2007-08 to 2009-10, revealed that the Company was under utilizing the manufacturing facilities available in its units.

Out of a total of 28,052 parts which were being manufactured by the sister units, only 2334 parts (8.32 per cent) were procured through these units and the remaining 25,718 parts (91.68 per cent) were procured by the company from outside vendors.

The Management while responding (December 2010), was however, silent on the justification for procuring components worth ₹ 355.27 crore from outside source and stated that the facilities for manufacture of the items under the sample list do not exist. Further, the Management added that the procurement of material / components is done only when the same cannot be manufactured in-house.

However, the fact remains that the Company did procure items from outside sources despite these being manufactured by its own units without documented justification.

The Ministry informed (March 2011) that the Company has been advised to explore the possibilities of producing the items in-house, before purchasing the same from outside as also to circulate the information about components which are proposed to be procured, to the other units who will intimate whether they can manufacture these items or not.

3.4 Inadequacies in Procurement module of ERP system (SAP)

In order to facilitate the Management to take right decisions at right time, the business enterprises need to have real-time, correct and meaningful database. The Company, in October 2006, introduced ERP in Bangalore Complex and in other units during 2007-08.

An exercise was conducted in audit to assess the effectiveness of the system and the following inadequacies were noticed:

- **Non-sharing of Vendor database** - Each unit maintained a separate database of vendors which was unit specific and was not being shared by other units while inviting quotations. Audit noticed that this deprived the units from reaping the benefits of competitive prices particularly when the vendor base of the company was thin.

Management while confirming the fact stated (December 2010) that each unit identified and created vendor list as per their requirements.

The Ministry stated (March 2011) that the Company has been advised to ensure that the restriction on sharing of vendor database among the units should be minimal.

- **Accounting of Rejections and Replacements** - Replacement of materials against the rejected items was not verifiable, as the replaced materials were being recorded as fresh receipts. The system was, thus, inadequate to monitor the receipt of the replaced material against the rejected items.

The Management confirmed (December 2010) that the replacements were being monitored outside the system.

Thus, to exercise better internal control over replacement against the rejected material the Company needs to strengthen the system suitably.

- **Vendor identification** - Though the Company was procuring components/material mainly for defence customers where quality and reliability was the main concern, Audit observed that the database did not support identification of vendors as original manufactures, authorized / franchise distributors and unauthorized distributors despite being repeatedly cautioned by the Corporate Standards wing of the Company.

The Management stated (December 2010) that system was being modified suitably.

- **Tracking Material Consumption** - The system was not able to track the consumption of materials received against a particular purchase order once it is received in the stores department.

Management contended (December 2010) that tracking of consumption to sale order was not required.

The reply is not tenable as tracking of consumption of a material would facilitate the company in ascertaining the profitability / loss of a particular transaction.

- **Advances to Suppliers** - System was not able to distinguish balances of advances lying with the suppliers between interest bearing and interest free, supported by bank guarantee and without supported by the bank guarantees.

While confirming the fact the Management stated (December 2010) that this would need creation of multiple codes in the system.

The fact remains that the system did not ensure effective control and monitoring of advances.

The Ministry intimated (March 2011) that the Company has been advised to modify the system to include tracking of material consumption and advances to suppliers.

In sum, the database of the company was not comprehensive and reliable as it lacked effective checks and controls which may impact its business decisions adversely and therefore, necessitated a revisit.