CHAPTER XIV: DEPARTMENT OF SHIPPING

Dredging Corporation of India Limited

14.1 Management of fuel

14.1.1 Introduction

14.1.1.1 Dredging Corporation of India (the Company) provides integrated dredging services to ports, Indian Navy, Shipyards and others. The Company operates two types of dredgers, viz., Cutter Suction Dredgers (CSDs) and Trailer Suction Hopper Dredgers (TSHDs). CSDs are used for capital dredging works which involves channel deepening and widening to accommodate larger vessels. TSHDs are used for maintenance of dredging which ensures that channels and berths are maintained at the required depth. The Company owned three CSDs and 10 TSHDs as of 31 March 2011.

14.1.1.2 The expenditure on fuel and lubricants constitutes, on an average, 39 *per cent* of the total operational expenses as shown below:

Year	Operational expenditure (₹ in crore)			*Per cent* of cost of fuel and lubricants to total cost
	Fuel and Lubricants	Others	Total	
2007 – 08	202.35	320.36	522.71	39
2008 – 09	202.75	468.22	670.97	30
2009 – 10	172.17	312.62	484.79	36
2010 – 11	199.48	129.79	329.27	61*
Total	**776.75**	**1230.99**	**2007.74**	**39**

****Abnormal increase in per cent in 2010-11 was due to high cost of fuel coupled with low expenditure on spares and stores and repairs & maintenance.***

14.1.1.3 The audit was conducted covering the activities of the Company relating to planning, procurement, consumption, monitoring etc. of fuel and lubricants to assess its impact on the profitability of the Company during 2007-08 to 2010-11. The sample selected for the study was fuel expenditure incurred by the Company on all the 10 TSHDs owned and three TSHDs hired by the Company which constituted 91 *per cent* to 98 *per cent* of the total cost of fuel and lubricants.

14.1.2 Audit Findings

14.1.2.1 Planning

The Company has been in the business of dredging for the past 35 years but has not done or commissioned a study to determine norms for fuel consumption by dredgers to achieve fuel efficiency, more so given that fuel and lubricants cost nearly $2/5^{th}$ of the operational expenditure of the Company. Further, it is seen that the MoU norms for fuel consumption decided by the Company were much higher than the previous year's consumption as well as the builder's norms. The year – wise details are presented below:

Dredge No.	Builder's norm of fuel consumption (at Company's operating level of up to 70*per cent* MCR) KL/ day	2007-08		2008-09		2009-10		2010-11		Average of best performance for 6 years ending 2010-11 KL/day
		MoU norm KL/day	Actual consump-tion rate KL/day	MoU norm KL/day	Actual consump-tion rate KL/day	MoU norm KL/day	Actual consump-tion rate KL/day	MoU norm KL/day	Actual consump-tion rate KL/day	
V	8.41	8.65	7.96	8.65	7.62	8.65	6.51	8.65	6.33	6.66
VI	8.41	8.65	7.32	8.65	6.65	8.65	7.47	8.65	7.75	6.61
VIII	9.99	14.30	13.41	14.30	10.79	14.30	10.41	14.30	11.10	11.10
IX	18.07	18.10	18.33	18.10	19.26	18.10	18.19	18.10	16.82	16.15
XI	18.07	18.10	19.34	18.10	15.07	18.10	12.09	18.10	16.85	18.36
XII	13.99	17.60	16.49	17.60	17.65	18.10	16.77	18.10	17.38	15.86
XIV	13.99	17.60	19.91	17.60	17.00	18.10	16.03	18.10	15.98	15.87
XV	19.39	24.50	23.68	24.50	23.61	26.00	21.25	26.00	23.97	22.01
XVI	19.39	24.50	24.39	24.50	24.90	26.00	23.67	26.00	25.00	18.21
XVII	19.39	24.50	24.32	24.50	23.50	26.00	25.21	26.00	24.50	21.89
Overall		**17.90**	**19.07**	**17.90**	**17.72**	**19.00**	**15.47**	**19.00**	**16.60**	

The Company had brought out some operational guidelines for achieving fuel efficiency. However, there was nothing on record to prove that the guidelines were conveyed to the dredgers and any suitable mechanism was laid down to monitor their adherence. Fuel consumption higher than builders' norms led to an excess expenditure of ₹ 85.71 crore during the period under audit.

The Ministry replied (January 2012) that the fuel consumption was arrived at on the basis of Specific Fuel Consumption data given by the Original Equipment Manufacturers for the equipments. Bringing out the multiple factors influencing fuel consumptions, the Ministry stated that dredger wise and port wise standardisation could not be carried out inspite of appointing The Energy and Resources Institute (TERI) to evolve a specific fuel consumption norm per dredger.

The reply of the Ministry is not tenable as the final fuel consumption targeted was higher than the builders' norms. Further, the Company has been in the business for 35 years and is aware of the all the factors that influence the fuel consumption and hence, the reply that the multiple factors make it impossible to fix levels of consumption is not satisfactory. The study conducted by TERI (November 2004) was only for the purpose of ascertaining whether the engines were performing well by studying the consumption pattern of one of the ten dredgers of the Company and hence this study was not relevant to the audit point.

The Company has agreed to consider the recommendations of audit for further study and called budgetary quotes from Indian Register of Shipping, Lloyds Register of Asia, Petroleum Conservation Research Institute, Bureau Veritas and Indian Oil Corporation of India Limited for conducting a study on the present fuel consumption by all DCI dredgers and to suggest suitable norms for fixation of fuel consumption for each dredger.

14.1.2.2 Procurement

As per the Company's Manual on Purchase Procedure, open tender enquiry is to be issued in cases where the estimated tender value is ₹ 50 lakh or more for products whose prices are not controlled by the Government. However, for the procurement of fuel and lubricants, the Company never invited tenders and sourced its entire requirement of Light Diesel Oil (LDO) and High Flash High Speed Diesel (HFHSD), both of which it used during the period under audit, only from Indian Oil Corporation Limited (IOCL) on the

ground that IOCL alone is capable of supplying bunkers at all the dredging locations where it operates and that the prices of fuel is controlled by the Government. Further, it did not obtain any specific approval of the Board of Directors for deviating from its approved procedure. Moreover, the Company did not follow regular internal control procedures like (a) sending of indent by the competent authority to the Material Management Department; (b) placing a formal purchase order or entering into a long term fuel supply agreement with IOCL; (c) obtaining specific approval of competent authority before placing order etc.

Further, the Company lost an opportunity of availing a reduction in fuel costs by ₹ 3.38 crore on the 18,790 KL of LDO procured in 2007-08 as other parties which went in for competitive bidding availed themselves of an average discount of ₹ 1,800/KL. Further, it was seen that HPCL extended, on an average, discount of ₹ 310/KL on HSD also owing to competition among OMCs. Hence, the Company incurred an opportunity loss of nearly ₹ 4.89 crore due to procurement of 1, 57,673 KL of HFHSD during the four years ending 2010-11 without establishing competitive prices. Further, the Company did not call for an Expression of Interest for its annual estimated quantity of fuel and lubricants at various locations which would have enabled the OMCs to compute the economies of scale to create infrastructure. Moreover, IOCL withdrew the one month credit facility to the Company which led to additional financial burden in the form of interest of ₹ 1.71 Crore while IOCL was allowing 2 to 3 weeks credit facility to Visakhapatnam Port Trust. Due to this flawed practice of not inviting tenders and sourcing the entire requirement from IOCL only, the Company deprived itself of negotiating better price and better payment terms.

The Ministry stated (January 2012) that there is no need to call for quotations as prices of LDO/ HFHSD are controlled by the Government. Further, the Ministry stated that calling of quotations for obtaining bulk discounts has the constraint of immediate supply to the dredgers due to lack of sufficient logistic support facilities of other OMCs of the other oil companies. The Ministry stated that the earlier efforts of the Company for procuring fuel from other companies like BPCL and HPCL were not successful because of their comparatively inferior infrastructure facilities/poor response. Further, it was stated that the Company has a formal system of indenting/ordering/receiving/bill payment/ monitoring and detailed instructions were issued for revamping the existing system in October 2010.

The reply of the Ministry is not tenable as price of LDO/ HFHSD are decontrolled and quotations should have been called for these as per the policy. Further, the Company did not attempt to tender its requirement declaring the overall annual requirement for proving or disproving the capabilities of other oil companies to match the infrastructure advantage which IOCL purportedly enjoys. Further, as pointed out in audit, there are no regular internal control procedures like sending indent by the competent authority to its Material Management department/ placing a formal purchase order or entering into a long term fuel supply agreement with IOCL documenting its requirement and commercial terms and conditions/ obtaining specific approval of competent authority before placing order etc.

14.1.2.3 Issue and consumption of fuel and lubricants

It was noticed in audit that the bunkering requirement is assessed by the Chief Engineering Officer (CEO) of each dredger who sends an indent for fuel and lubricants to

the Project Manager of the Company at the respective location of dredging which in turn is forwarded to IOCL to supply the requisitioned quantity. A Marine Delivery Receipt is signed by the CEO of the respective vessel and IOCL representative(s) immediately after the bunkering certifying the quantity, date and location at which the bunkers are supplied. IOCL raises invoices for the bunkers supplied on the basis of the MDR. Further there is no laid down procedure for recording consumption of fuel on board the dredgers. Moreover, there was no system of reconciliation of fuel consumption (a) as declared by the dredgers based on Daily Utilization Reports (DURs) and (b) as arrived at based on the details of fuel supplied to dredgers based on requisitions during the course of the year by the Head Office. On reconciliation between fuel consumed as per DURs and Finance Bill register in all 10 TSHDS during four years ending 31 March 2011, Audit noticed there were discrepancies which needed to be reconciled as indicated below:

Item	2007-08	2008-09	2009-10	2010-11
Fuel issued to the dredgers as per Finance Bill Register (in KL)	48870	45694	43360	47816
Less: Closing balance as per the above register (in KL)	2011	2323	2428	2974
Quantity consumed as per Finance Bill Register (in KL) (a)	46859	43371	40932	44841
Quantity declared to be consumed as per Daily Utilization Reports (DURs) of the dredgers (in KL) (b)	45844	41349	38209	45321
Difference (in KL) (a) – (b)	1015	2022	2723	-480
Average price of fuel (₹ per KL)	32802	36401	36640	41991
Value of non reconciled stock (₹ in crore)	**3.33**	**7.36**	**9.98**	**-2.01**

The cause for the above discrepancy was not analyzed by the Company. The non-existence of a system of reconciliation pre-empts the possibility of bringing in systemic changes or improved internal control measures after identifying the causes for proper stock and consumption accounting.

The Ministry stated (January 2012) that reconciliation of fuel consumption is based on the Utilisation Reports (DUR) and engine log book data. Informatively, the DUR data received from the dredgers comprise of reserve on board along with fuel consumption on day to day basis and is being monitored by the Company.

The reply of the Ministry is not tenable as it is silent about reasons for shortages pointed out in the para as well as non-reconciliation of fuel consumption declared by the dredgers based DURs vis-à-vis as arrived at based on the details of fuel supplied to dredgers. Further, even though DUR comprises of reserve on board along with fuel consumption, the audit considered consumption quantities only.

Supply of fuel at Sethusamundram Canal Project

Of the eight TSHDs chartered by the Company to carry out dredging operations at Sethusamudram Canal Project (SCP), the Company was to supply fuel to three dredgers as per contract which, *inter- alia*, provided for a minimum guaranteed production by each of the TSHDs. The details of fuel supply rate and guaranteed production rate agreed in the chartering contract along with dredging days in respect of two out of the three TSHDs chartered are indicated in the following table.

Name of TSHD	Date of contract	No. of days	Fuel supply rate KL/ day	Guaranteed Production Cu.m/ day
Sagar Hansa	04.04.07	119	36.00	19285.71
Pacifique	17.01.07	104	29.16	27652.14

Note: There is no issue in case of third chartered TSHD 'Professor Gorjunov'.

The agreements do not provide for reduction in supply of fuel corresponding to the shortfall in achieving the guaranteed production. Consequently, even though the actual production achieved by the above two TSHDs was only 82 *per cent* and 59 *per cent* respectively of their guaranteed production, the supply of the fuel rate was not restricted to the percentage of the achievement resulting in excess issue of 1691 KL of fuel valuing ₹ 5.55 crore. Further, in respect of two hired TSHDs (Gorjunov and Sagar Hansa), the fuel issue rate agreed in the contract was higher than the actual fuel consumption rate of similar TSHDs owned by the Company (even though their installed power as compared to Company's TSHDs was slightly higher) resulting in excess fuel being issued to them. Consequently, the Company allowed an excess fuel valuing ₹ 19.42 crore to the two chartered TSHDs. The Ministry replied (January 2012) that the recommendations of audit would be taken into consideration while entering into charter agreements in future for hiring of dredgers.

14.1.2.4 Claims for reimbursement of fuel escalation

The terms for raising of claims by the Company vary from customer to customer. It was observed that the delays in raising fuel escalation claims ranged from 10 days to 319 days as per the details given in the following table.

Delays in raising claims	Instances
0 to 30 days	4
31 to 120 days	48
121 to 210 days	11
211 to 300 days	6
300 to 400 days	1
Total	**70**

As at the end of 31 March 2011, claims valued ₹ 210.38 crore were made with delays resulting in an interest loss of ₹ 5.90[♣] crore.

The Ministry stated (January 2012) that the delays in raising fuel escalation claims are partly due to delay in receiving bills form IOC for adjustment after making the weekly advance. The matter is being continuously pursued with IOC. The reply of the Ministry is not tenable as the issue is about delay on the part of the Company in raising claims. The Company should have raised the claims promptly. Further, the Company should have insisted on a suitable clause for submission of bills by IOC in time.

A similar observation on fuel and material escalation was reported in the Para No. 19.1.1 of CAGs Report No. 11 of 2008. It was pointed out that there were avoidable delays in raising escalation claims ranging from 15 to 118 days for fuel and upto 550 days for material which resulted in loss of interest of ₹ 2.93 crore. The Ministry of Shipping (Ministry) in its Action Taken Note (ATN) (July 2008) stated that in order to expedite raising of escalation claims in respect of fuel, internal arrangements have been

[♣] ***Aggregate of average interest rates from year of claim to end March 2011 applied.***

made to forward the bills immediately on payment to project office and checking with log books is being carried out separately. But, audit noticed for the subsequent periods in the contracts entered into with Visakhapatnam Port Trust, Paradip Port Trust, Mormugao Port Trust, Naval Command (Kochi) that the Company continues to raise claims on account of fuel/ material escalation belatedly and the action taken as per the ATN of the Ministry is, therefore, not convincing.

A review of fuel escalation claims for the years 2007-08 to 2010-11 revealed that there were 70 outstanding claims as of 31 March 2011. Out of these, 15 cases amounting to ₹8.99 crore related to the period prior to 2007-08. It was noticed that there were delays in realizing amounts from customers ranging from 19 days to 1643 days as shown below:

Delays in realizing bills	Instances
0 to 30 days	4
31 to 120 days	23
121 to 300 days	18
301 to 400 days	9
401 to 900 days	1
901 to 1000 days	0
Greater than 1000 days	15
Total	**70**

Due to non existence of any contractual provision relating to levy of interest on delayed payment of fuel escalation claim, the Company suffered interest loss amounting to ₹ 19.41[♥] crore.

14.1.2.5 Oversight Role

Governance by the Board of Directors

The following deficiencies were noticed in the governance of the Company:

- In this increasing competitive world, the importance of cost reduction cannot be over emphasised. In the eleven quarterly reviews of performance of the Company by the Board of Directors, only on four occasions did the Board express concern about slippage of MoU ratings. On all the other occasions, the performance was only noted.
- Regarding the fuel consumption targets set in the MoU, the Board did not give due cognizance to the fixation of MoU norms based on scientific basis. Further, neither did the Board analyse or seek reasons for either good or bad performance nor did it give any guidance/ recommendations for improvement.
- Though the Board desired that strategy meetings should be held on a periodical basis to improve the performance of the Company, it did not ensure the adherence to its instructions till date which implies lack of follow-up by the Board of its instructions.

The Ministry stated (January 2012) that the fuel consumption norms as reflected in the MOU parameter are fixed not only basing on the OEM recommended SFOC but also the actual consumption trends observed with the experience gained over the years. The

[♥] ***Aggregate of average interest rates from year of claim to end March 2011 applied.***

actual performance against MOU targets is submitted to Board of Directors on quarterly basis and the performance is analyzed and discussed in the Board meetings.

It is to be stated here that though the average consumption was computed based on the SFOC of the OEM, the final figure of fuel consumption considered for each dredger in the MOU was above builder's norms as discussed in the Para 2.1.1 above and consequently, the targets for fuel consumption were not fixed scientifically.

Review of performance by the Administrative Ministry

Review of the performance of the Company by the Administrative Ministry is through the parameters agreed upon in the annual MoU. Since consumption of fuel and lubricants by the dredgers is a vital parameter affecting the profitability of the Company, it should have been given a higher weightage during the overall evaluation of the performance. On the contrary, the weightage for fuel consumption was reduced continuously year after year from 'seven' for the years 2005-06 to 2007-08 to 'five' for 2008-09, 'four' for 2009-10 and 'three' for 2010-11. Thus, this vital parameter which constitutes 39 *per cent* of operational expenditure has just 3 *per cent* weightage in the MoU.

Conclusion

The Company did not focus on optimisation of expenditure on fuel and lubricants. The Company did not fix the norms for fuel consumption rate on a scientific assessment, followed inappropriate purchase procedure for sourcing the requirement, did not determining competitive prices for procurement of fuel and lubricants and had inadequate internal control procedures for procurement of fuel and lubricants. There was no proper system and procedure to ensure regular reconciliation of fuel consumed with the issues made, prompt raising of claims for fuel escalation as well as realizing the amounts, linking the guaranteed performance and fuel supply rate agreed as per the agreements for chartering of dredgers. These deficiencies indicate a lack of professional handling of fuel consumption issues.

As a result of the above deficiencies, the Company lost an opportunity to save ₹ 164.63 crore on fuel consumption during 2007-11. This amount is equal to 49 *per cent* of the Profit Before Tax (₹ 335.19 crore) reported by the Company during these years. This shows that a professional approach in fuel management can bring in tremendous benefits to the Company and improve its bottom line substantially.

Recommendations

- ***The Company should fix norms for fuel consumption scientifically and should analyse the causes for low and high fuel consumption periodically.***
- ***The Company should consider invitation of tenders to meet its requirement of fuel and lubricants to obtain competitive rates and commercial terms.***
- ***Claims should be raised within 15 days of completion of dredging cycle and incorporate a provision for levying interest on delayed payment of fuel escalation claims.***
- ***The Ministry may ensure that (a) parameter of fuel consumption gets appropriate weightage in the MoU scheme and (b) the fuel consumption targets are fixed scientifically.***

The matter was referred to the Ministry in March 2012; their reply was awaited (May 2012).

The Shipping Corporation of India Limited

14.2 Investment in Joint Venture

The Shipping Corporation of India Limited did not conduct detailed study before entering into a Joint Venture for chemical tanker operations. The initially approved investment of ₹ 45 crore in the year 2006 increased to ₹ 141.80 crore in the year 2011 with no returns. The Company also suffered a loss of ₹ 32.56 crore towards operation of vessels.

The Shipping Corporation of India (SCI) entered into a Memorandum of Understanding (MOU) with Forbes and Sterling on 19 April 2006 with a view to form a Joint Venture (JV) for acquisition, managing and operating chemical tankers for the transportation of chemicals. Even before the MOU was signed Forbes and Sterling had decided to acquire, manage and operate chemical tankers either directly or through Joint Ventures, had held discussions with South Korean shipyards and had initiated to place a Letter of Intent (LOI) to freeze the price at about US$ 25 million per ship by the middle of April 2006. Accordingly, the MOU stated that Forbes Sterling will hold the prime responsibility for identifying the vessels to be acquired. Further, the MOU stated that in order to place orders for the ships before April 2006, SCI was to get the necessary approval from its board so that it could participate in the proposed JV before end of April 2006.

In the meeting of the Board of Directors (BOD) of SCI held on 25 April 2006, the BOD considered the proposal for a total investment of US$ 100 million for acquiring four tankers by the JV. The financing was to be done to the extent of 80 *per cent* by loans and 20 *per cent* through equal equity participation by both the JV Partners. The charter hire was estimated at US$ 13000 per day per ship. The BOD was apprised of the projected huge increase in refining capacity in India and the increase in demand for transporting vegetable oils and chemicals. The JV was expected to provide synergy for SCI and enable it to acquire chemical tankers through the Joint Venture route in an expeditious manner. The BOD approved formation of JV and equity investment of ₹ 45 crore.

A shareholders agreement was signed on 14 June 2006. As regards financing, it stated "All necessary funds for the operations and activities of the JVC which may not be covered by the subscribed and paid up capital shall be secured by injections of shareholders funds in proportion to their shareholdings in the JVC, or as shareholders loans. The Parties may however borrow/raise resources from Bankers, Financial Institutions." The agreement further stated that the BOD of JV was to have six non executive Directors, three each from both the partners. SCI nominated three members on the Board.

The ship building contract for four vessels was signed on 28 June 2006 between Forbes Sterling and the South Korean Shipyard. The JV was incorporated on 18 July 2006 as SCI Forbes Limited.

After the initial investment approval in April 2006, the SCI Board in its meeting held after more than two years in July 2008 deliberated on the estimation for other items of project cost given by the JV. Such cost related to interest during construction, preliminary and pre-operative expenses before delivery of the vessels. Such estimation increased the project cost to US$ 121.65 million. The financing arrangement was also discussed leading to the signing (August 2008) of sponsor support deed. The financing of the

vessels was done by NATIXIS – HSBC bank through a loan agreement (August 2008). As per the loan agreement SCI had to provide cash deposits to sustain the requisite level of asset coverage. This led to further investments by SCI in the JV. The total investment of SCI in JV was ₹ 141.80 crore as on 31 March 2011.

A Committee was constituted by the Board (February 2011) to go into the working of SCI Forbes Limited and it submitted its report in June 2011. The Committee observed that there was no detailed project feasibility study either in-house or by an external agency. The valuation and inspection records prior to acquisition of vessels indicated that there was no evidence of visit to the yard. The revision of project cost in 2008 indicated omission of some costs in the initial estimates. Though SCI alone had some experience of operating chemical tankers it was incurring losses and the segment was not doing well even in 2007-08. The JV which started its chemical tankers business in July 2007 by in-chartering a vessel suffered losses in spite of surplus projected to the Board with the calculations made in March 2007 much at variance with the actuals, a few months later. Subsequently the JV acquired 4 ships between August 2009 and May 2010. The JV had outsourced the man power and technical management of the ships and the vessels were chartered to the JV partners who in turn sub-chartered those ships to the Womar Pool for commercial operations. Such an arrangement led to a large gap between the actual amount of US$ 13000 per day payable by each of the partners to the JV and the amount realized per day leading to huge loss in the balance sheet of the JV partners. The SCI had booked a loss of ₹ 32.56 crore towards standby charter agreement. While reviewing the option of ceasing the operations and winding up of the JV, the committee observed that after liquidating the liabilities of ₹ 333 crore by selling the vessels at ₹ 297 crore and utilizing the reserves, the JV would be left with a cash surplus of ₹ 125 crore (which means ₹ 62.50 crore for SCI as against the investment of ₹ 141.80 crore). The Committee concluded that the SCI might review the need to continue the JV as the JV had realized no strategic advantage or purpose for the SCI.

Audit observed that when the MOU and the JV were signed in 2006, SCI was a Mini-Ratna Company with delegated powers to enter into JVs involving investment of ₹ 500 crore as per the DPE guidelines (August 2005). The proposal submitted to the Board was not in conformity with the DPE guidelines (October 1997) for formation of JVs which provided that all such proposals should be prepared by or with the assistance of professionals and experts and appraised, in suitable cases, by financial institutions or reputed professional organization with expertise in the area.

When the aspect of not conducting a detailed feasibility study was brought (September 2011) to the notice of the Management, it replied (October 2011) that the acquisition proposal for the four chemical tankers (on account of JVC) was evaluated in terms of the same yardstick (as if it were SCI's own acquisition proposal) and the same passed muster.

In this connection, it was observed that the procedure (January 2001) for acquisition of ships provided that the acquisition would be related to the long term perspective plan of the Company. During the 10th plan period SCI had envisaged the acquisition of 31 vessels. It did not include acquisition of chemical tankers. This indicated that the Company had not visualized chemical tanker business in its long term plan.

Further, the established procedure for acquisition of own vessels also provided for preparation of a Project Report containing the projections like Internal Rate of Return

(IRR) and the Economic Rate of Return (ERR), each exceeding 12 *per cent*. IRR/ERR below the prescribed rate of 12 *per cent* was required to be justified by the Company and referred to the Government. The Project Report was to be based upon the then prevailing freight/charter hire rate and trends in international freight rates over a period of time were also required to be brought out in the said Report.

However, no Project Report was prepared in the instant case. The project IRR of the JV was 11.23 *per cent* (later revised to 10.69 *per cent* in July 2008) as against 12 *per cent* stipulated in the established procedure. Trends in international freight rates over a period of time were also not brought out in the proposal and only the then prevailing freight/charter hire rate was informed to the Board.

It was noticed that that Drewry Chemical Forecaster Quarter 4, 2005, which the Company depended upon for comparing the prevailing market price for chemical tankers, reported surplus capacity in the chemical tanker segment ranging from 13 to 30 *per cent* of the demand from 2000 to 2004. It also projected a surplus capacity ranging from 20 to 28 *per cent* of the demand during 2005 to 2009. However, this aspect was not brought to the knowledge of the BOD while seeking approval for the investment in the JV.

The loan financing was also not fully analysed by the BOD. The implications of (i) raising of loan by a new Company with no balance sheet (ii) risks relating to security value maintenance and (iii) any downward fall in the freight rates in future were not taken into account.

The MOU and the JV were subsequent to the decision already taken by Forbes Sterling to acquire chemical tankers. SCI was a premium national carrier of India while Forbes Sterling had practically no experience in chemical tanker trade. The board meeting was held on 25 April 2006 within six days of entering into of MOU which had clauses compelling the Company to complete the JV agreement by April 2006.

The JV agreement was, thus, entered into without going into the financial implication of the project as borne out by the subsequent developments as detailed above. The advantages of forming a JV for acquisition and operation of chemical tankers by SCI directly were never discussed. In the process the JV has become a drag on the Company's finances. The Company has also not got any strategic advantage as envisaged.

The Management stated (October 2011) that ship acquisition project did not involve any complexities and therefore, it did not consider it necessary for the investment proposal to be appraised by financial institutions or reputed professional organizations and that the need and justification for chemical carriers, economic viability etc. were reported to the BOD in April 2006. Regarding increase in the investment, it replied that at the time of formation promoters were seized of the working capital requirement and agreed that the same might be established with more accuracy at the time of delivery of the vessels. As regards inchartering of vessels at US$ 13000 per day, it stated that the two vessels were inchartered under a standby charter agreement to secure shipbuilding loans from the lending banks and therefore, the daily hire rate of inchartered vessels could not be compared with the prevailing chemical tanker hire rates.

The reply was not convincing due to the following:

- The total project cost of US$ 100 million was substantial and required a detailed study as per DPE guidelines. In fact, if a detailed study had been carried out, the increase in the project cost could have been visualized initially and submitted to the BOD.
- The project was to be financed with 80 *per cent* loan. However, while approving the project the following were not factored in:-
  - risks relating to security value maintenance in the background of JV not having any other free vessel to offer as collateral
  - any downward fall in the freight rates in future.
- Management had projected (April 2006) huge growth in the petrochemical industry in the country and high potential for the chemical tankers. However, the projection for chemical tankers did not materialize and the Company had to incharter the vessels in terms of the agreement with the lending banks at a steep rate of US$ 13000 per day resulting in a loss of ₹ 32.56 crore.

Thus, due to failure of the Company to conduct a detailed study to assess all the risk factors, the initially proposed investment of ₹ 45 crore increased to ₹ 141.80 crore as on 31 March 2011, which did not generate any return. Further, the Company had to suffer a loss of ₹ 32.56 crore during August 2009 to June 2011 for sustenance of the JV. Admittedly, the investment in the JV did not realize any strategic advantage or purpose to the Company.

The matter was reported to the Ministry in October 2011; their reply was awaited (May 2012).

14.3 Avoidable expenditure due to delay in finalization of contract

Inordinate delay in finalisation of contract for supply of stores items resulted in avoidable expenditure of ₹ 7.62 crore.

The Shipping Corporation of India Limited (Company) had been entering into rate contracts, normally for two years, for supply of stores items required for operation of vessels. The purchase manual of the Company provided for an option for extension of these contracts for a period of six months beyond the normal tenure of two years. Purchase Manual also stipulated that the tender procedure should be completed before the expiry of existing contract so as to take a decision whether to extend the contract by exercising the option or enter into a fresh contract, depending upon the competitiveness of rates.

The Company had entered into a contract for supply of stores items in May 2004 (effective from January 2004) with an option for extension. As the contract was due to expire in December 2005, the process for entering into a new contract was started by the Company in August 2005. However, the same got delayed on account of observations of the tender processing committee regarding categorisation of various price list items in the tender format. The Company could issue the notice inviting tenders only in August 2006 with 26 September 2006 as the due date. In the mean-time, the existing contractors continued to supply the stores items.

In response to the notice inviting tenders, the Company received (September 2006) offers from 12 parties out of which seven parties were technically qualified on 29 December 2006. The price bids of these seven parties were opened on 12 January 2007 and the quotes of M/s. Laxmi Enterprises (L1) were found to be the lowest being 63.47 *per cent* lower than the rates at which supplies were received under the earlier contract. However, the Company failed to finalise the contract within the validity period of the offer (March 2007) as per the general terms and conditions of the tender. Consequently, L1 withdrew the offer in April 2007.

Though there were clear directions of Central Vigilance Commission to re-tender in case of L-1 backing out, yet the Company offered (May 2007) the L1 rates to the remaining parties, However, the parties refused to accept the L1 rates but agreed to supply the stores items at L2 rates, which were 44.36 *per cent* lower than the rates under the earlier contract. The Management decided (July 2007) to award the contract to the existing four contractors at the L2 rates for six months from July 2007 onwards which was further extended upto September 2009 from time to time. The Company could finalise a new contract for one year from 1 October 2009 on competitive bidding basis only in October 2009.

Thus, due to non finalisation of contract with the L1 within the offer validity period, the Company had to procure stores at L2 rates for the period from January 2006 to September 2009 though the L1 rate was 34.35 *per cent*[1] lower than the L2 rates.

The Company failed to provide the complete data regarding the procurements made from January 2006 to September 2009 to Audit except for the period from July 2007 to June 2008. During the said one year, the Company purchased stores items of ₹ 22.17 crore at L2 rates resulting in an extra expenditure of ₹ 7.62 crore[2] as compared to L1 rates. The actual loss would be much more taking into account the full period of supplies during the 45 months i.e. from January 2006 to September 2009.

The Management attributed (September 2011) the delay in finalisation of tender to the efforts made by the Company to streamline the tendering process, enormity of work involved in processing of the technical and price bids, involvement of concerned officials in the integrated information technology system which delayed the handling of day-to-day work, processing of various other critical tenders and manpower constraints.

The reply of the Management is not acceptable as:

- system improvement in the tendering process cannot be a justification for inordinate delay in finalizing a contract.
- L1 withdrew due to non-finalization of the contract within the validity period of the offer as stipulated by the Company. The Management should have planned the process in advance taking into account the enormity of the same and man-power constraints, if any.

The inordinate delay in finalisation of contract resulted in avoidable expenditure of ₹ 7.62 crore in procurement of the stores items from July 2007 to June 2008. Additional expenditure incurred during the remaining period i.e. from January

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[1] ***Assuming initial rate at ₹ 100, L2 rate at ₹ 55.64 and L1 rate at ₹ 36.53 and using the formula [(L2-L1)/L2]* 100 = [(55.64-36.53)/55.64]*100 = 34.35 per cent***

[2] ***Purchases at L2 rate * 34.35 per cent = ₹ 22.17 crore * 34.35 percent = ₹ 7.62 crore***

2006 to June 2007 and from July 2008 to September 2009 could not be computed due to non-furnishing of the data by the Management.

The matter was reported to the Ministry in October 2011; their reply was awaited (May 2012).