

CHAPTER-8

Fixation and Achievement of MoU Targets

8.1 Memorandum of Understanding

Memorandum of Understanding (MOU) as applicable to the Central Public Sector Enterprises (CPSEs) is a negotiated document between the Government of India (*i.e.* the concerned administrative Ministry) and the Management of the CPSE specifying clearly the objectives of the Understanding and the obligations of both parties. MOU is meant to evaluate the operating performance of the CPSE which includes the progress of project implementation through fixation of targets for various parameters.

8.2 Performance of BHEL against MOU Targets

DPE issues guidelines every year for drafting and finalization of MOUs between CPSEs and respective administrative Ministries according to which all CPSEs are required to sign MOU with the respective administrative Ministry failing which their performance is liable to be rated as 'Poor'. BHEL has been signing MOU with its administrative Ministry, *viz.* Ministry of Heavy Industries (Department of Heavy Industries, herein after referred to as Ministry) every year.

Composite scores and corresponding MOU ratings achieved by BHEL during the last five years *i.e.* 2007-08 to 2011-12 were as detailed in Table 31.

Table 31

Year	Composite Score	MOU Rating
2007-08	1.19	Excellent
2008-09	2.64	Good
2009-10	1.17	Excellent
2010-11	1.02	Excellent
2011-12	1.08	Excellent

Targets against each parameter are specified in the MOU by MHI for BHEL as a whole. Based on MOU targets, BHEL on its own, works out parameter wise targets in respect of its Units for judging their performance internally every year.

Audit examined the adequacy of the (i) system of fixation of performance targets for various parameters under MOU for the period of five years *i.e.* 2007-08 to 2011-12 and (ii) assessment of actual performance against the targets fixed with a view to obtaining an assurance on the extent of actual achievement of objectives mainly related to capacity utilisation and Research and Development. Audit findings on these issues are discussed in paragraphs 8.3 and 8.4 respectively.

8.3 Fixation of targets

8.3.1 Need for rational fixation of Non Financial Parameters

A CPSE can select non-financial performance parameters in consultation with the administrative Ministry/Department which are considered crucial to its functioning and fulfilment of its objectives. However, non-financial performance parameters fixed should be SMART (Specific, Measurable, Attainable, Results-oriented, Tangible) and consistent with the Annual Plan/ Budget/Corporate plan of the CPSE. MOU signed by BHEL included 12 main non-financial parameters⁵³. These parameters and targets were fixed after deliberations with BHEL by the Task force constituted by Ministry.

Audit examined fixation of targets for three main non financial parameters pertaining to capacity utilisation and Research and Development and observed following inadequacies:

(i) Delivery index of 'on-time' deliveries in customer projects

The number of projects considered for evaluation under this parameter and the total number of projects scheduled for delivery (as per contracts with customers) during the respective years are indicated in Table 32 below:

Table 32

Year	Number of Projects (Capacity in MW) scheduled for delivery during the year	Number of Projects (Capacity in MW) considered for performance evaluation in the MOU parameter	Percentage of number of projects (percentage of capacity in MW) considered in MOU target
2007-08	70 (16,121 MW)	9 (1,504 MW)	13 (9)
2008-09	58 (17,571 MW)	18 (3,268 MW)	31 (19)
2009-10	52 (18,054 MW)	28 (6,151MW)	54 (34)
2010-11	43 (20,750 MW)	22 (7,118 MW)	52 (34)
2011-12	73 (39,143 MW)	58 (12,201 MW)	80 (31)

MOUs were, thus, based on performance of lesser number of projects (13 to 80 *per cent*) than required to be executed by BHEL during these years and did not comprehensively reflect the ability of BHEL to deliver the projects timely during these years compared to their original delivery schedule. Further, though number of projects covered in MOUs increased over the period 2007-12 from 13 to 80 *per cent*, their significance in terms of capacity addition (in MW) to be delivered ranged from only 9 to 34 *per cent* of total capacity (in MW) planned to be delivered. Minutes of the meetings or other records for negotiations of MOU targets in the respective years between Ministry and BHEL did not contain any recorded reasons for excluding or including particular projects.

Management noted (September 2013) the audit observation and stated that DPE is the final authority for selection of projects for fixation of targets under MOU.

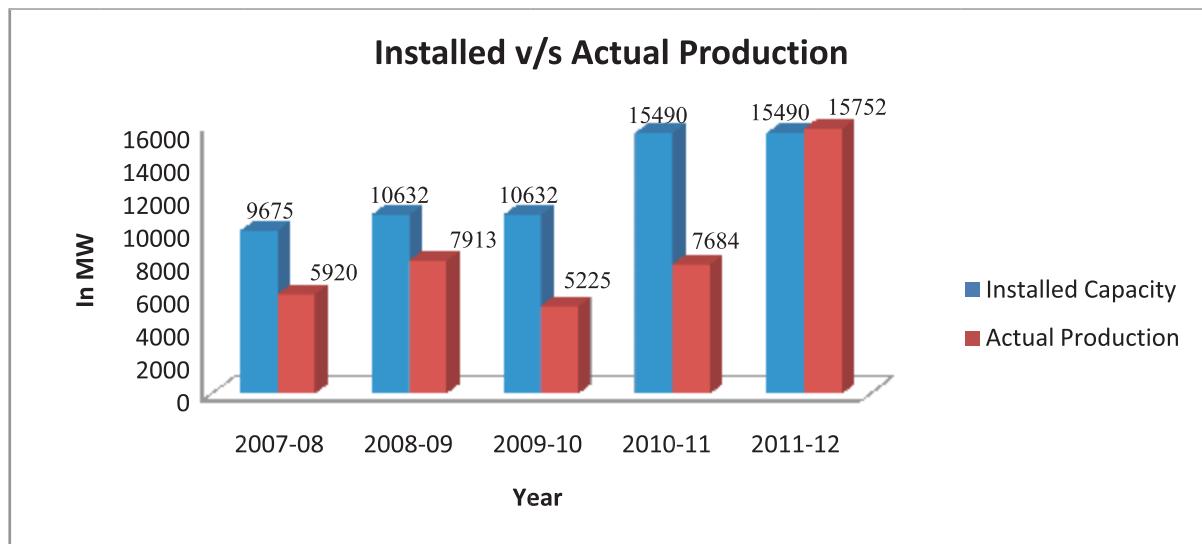
⁵³ *Quality and Customer satisfaction, Human Resources, Engineering and R&D, Project Implementation (Modernization and Expansion), Capital expenditure, Extent of globalization, Technology Development of projects, Delivery Index of on time deliveries in customer projects, JV agreements to be signed, Corporate Social Responsibility, Sundry Debtors & Inventory and Enterprise specific objective}*

The fact remains that the projects included for evaluation under the parameter should capture a significant part of the capacity planned to be delivered during the year, in order to make targets challenging.

(ii) Non inclusion of capacity utilization in physical terms as MOU parameter

MOUs for five years ending 31 March 2012 were mainly based on achievement of turnover by BHEL and no weightage was given for capacity utilization⁵⁴ of its manufacturing units which remained below the installed capacity⁵⁵ (except 2011-12) as shown in Chart 3:

Chart 3



Actual production has been adopted as one of the key parameters in MOUs signed by other CPSEs like NTPC Limited, SJVN Limited with weightage of 7 per cent and 5 per cent respectively.

Management stated (September 2013) that proposal of BHEL for inclusion of physical performance was not considered by the Task force in MOU 2013-14.

The fact remains that inclusion of physical performance being a significant parameter is likely to capture the overall performance of the Company in a more comprehensive manner.

8.4 Defects in assessment of performance against MOU parameters

Audit observed deficiencies in assessment of performance against the following parameters with respect to the DPE Guidelines as discussed below.

(i) Delivery index of 'on time' deliveries in customer projects

Delivery index of 'on time' deliveries measures performance of the Company in achievement of milestones of selected projects in the MOU. Audit examined the details of working of the delivery index furnished by the Management and observed

⁵⁴ As per Annual accounts of respective years

⁵⁵ Based on the installed capacity (in MW) of three manufacturing units viz HPEP-Hyderabad, HEP-Bhopal and HEEP-Haridwar as reflected in the Annual Accounts of BHEL for respective years.

that some activities of the selected projects considered for calculation of delivery index were actually completed either during previous year or after the MOU period. The index was thus, not worked out correctly by including only the activities that were completed during the relevant year.

Management stated (April/September 2013) that the parameter of delivery index developed in 2007-08 was validated in 2008-09 and accepted by the DPE Task Force. The principle of calculation of delivery index takes into account all the milestones of the project with corresponding weightages irrespective of the year in which project activity/milestone was completed. Accordingly, the targets were set and the performance scores were evaluated during the year.

Reply is to be viewed against the fact that the objective of MOU is to evaluate the performance of the Company for a particular year. Inclusion of activities which relate to years other than the year under reference is against the basic objective of evaluation of the performance for that year. Further, the Company did not provide the basis of finalizing the formula and weightages for calculation of delivery index. In the absence of basis of formula and weightages adopted for different milestones, it was not possible for Audit to work out the impact of this inadequacy on the overall MOU score of the Company.

(ii) Recognition of Revenue Expenditure in respect of R&D

Targets fixed by Ministry for achievement of 'excellent' rating in the MOUs for in house R&D expenditure and actual expenditure claimed by BHEL against these targets during 2007-12 are given in Table 33.

Table 33

(₹ in crore)

Target	2007-08	2008-09	2009-10	2010-11	2011-12	Total
Target fixed for excellent rating in MoU (R&D Exp)	210	340	494	600	900	2544
R&D Expenditure Claimed in performance of MOU	463.41	690.01	829.27	981.86	1198.82	4163.37
R& D expenditure as per Annual Audited Accounts ⁵⁶	295.79	421.09	369.88	421.73	444.24	1952.73

As per guidelines of DPE, MOU evaluation of CPSE is to be done based on the audited accounts and CPSEs have to submit self evaluation report based on audited data. BHEL, however, claimed expenditure under R&D in MOUs in excess of the amount shown in audited annual accounts resulting in over assessment of its achievement. Audit examined the details of ₹ 2852.29 crore out ₹ 4163.37 crore claimed as R&D expenditure under MOUs during 2007-12 and observed that R&D expenditure claimed in MOU performance included expenditure of ₹ 2210.64 crore

⁵⁶ As per Annual audited accounts of respective years and expenditure incurred on fixed assets for R&D Activities (building, Plant & Machinery and software), and lease rent paid for R&D office, etc.

on 'development against contracts' which mainly represented modifications carried out as part of specific commercial orders of customers and were not booked as R&D expenditure in the accounts of the Company.

Management stated (April /September 2013) that apart from activities which are captured in the annual audited accounts, a number of other R&D activities are undertaken and captured separately. Customer orders involved new designs and R&D efforts to meet the customers' specific requirements and modification of existing modules. Expenditure incurred on these activities was thus, considered as R&D expenditure.

Reply of the Management is to be viewed against the fact that guidelines of DPE specify that the actual figures in the MOU performance should be as per the audited accounts of the Company. Expenditure incurred by way of modification, design and development of processes to meet customer specific requirements are part of order execution which are billed to customers and recognized as turnover towards main equipment. This is not a part of R&D expenditure as per AS-26 as already discussed in para 7.3 *supra*.

BHEL, thus, claimed benefit in composite score by 0.08 points during all the three years from 2009-10 to 2011-12 respectively on account of R&D expenditure.

To sum up, there was scope for fixing appropriately challenging targets and evaluation of performance more objectively in line with DPE guidelines.

Management stated (April 2013) that targets against each financial parameter of MOU are finalised during negotiations with the DPE task force. Department of Heavy industries is also involved in these negotiations. DPE task force which negotiates the parameters is the same task force which is responsible for evaluation of the performance against the targets fixed in the MOU. Ministry endorsed (June 2013) the reply of Management.

The reply is to be viewed against the fact that it is the responsibility of BHEL as well as the Ministry to ensure that the MOU targets are fixed as well as evaluated as per the prescribed guidelines of DPE. Non-compliance of the guidelines defeats the purpose of objective and transparent evaluation of the performance of a CPSE.