CHAPTER II: MINISTRY OF CHEMICALS AND FERTILIZERS

Hindustan Organic Chemicals Limited

2.1 Irregularities in transfer of autonomous management of HOC school to Mahatma Education Society

Hindustan Organic Chemicals Limited extended irregular and unauthorised favors to Mahatma Education Society for expanding its activities and also failed to recover lease rent of ₹ 6.54 crore

Hindustan Organic Chemicals Limited (HOC) established (October 1966) a school to provide education to the wards of the employees. The school was run by HOC from 1966 to 1974. Thereafter the management of the school was transferred to Deccan Education Society, Pune (DES) on a 40 years lease from 1974 onwards. However, the management of the school was taken back as notice for termination was served by DES (May 2000).

HOC, initiated the tendering process (August 2000) to entrust the autonomous management of the school to a suitable institution. The Board of Directors decided (March 2006) to transfer the management of the HOC school to Mahatma Education Society (MES) selected through tendering process. HOC entered (October 2006) into a lease agreement with MES effective for 30 years from 1 June 2006. The agreement provided for payment of ₹ 14.50 lakh per annum as lease rent for school building/premises and school ground (14.23 acres) and that MES would take over the liability of teaching and non-teaching staff entirely (estimated saving of ₹ 13.50 lakh per month).

Subsequently, MES requested (October 2007) for grant of permission to start degree /professional courses like Polytechnic, Engineering, Management, etc. and also requested for allotment of 40–50 acres of land adjacent to the school premises for constructing new buildings for starting the courses. The Board of Directors decided (30 October 2007) that it was not in favour of releasing any further land for putting up separate structures for the school purposes as such a course of action would involve many legal problems at a later stage. The Board, however, felt that any idle buildings which the Company felt may not be in a position to put into use in the coming years may be detained to the school management to provide facilities for starting additional degree/professional courses at its own cost. The Board, however, while confirming (24 January 2008) the minutes of their meeting held on 30 October 2007 modified the minutes and recorded that MES may start up degree/professional courses only within the existing premises of HOC school and that no additional land will be made available to MES.

Audit examination revealed that even before the Board took its decision, the Chairman and Managing Director of HOC granted permission (26 October 2007) to MES for construction of new buildings on the vacant area of the educational complex at the latter's own expense. The lease rent in respect of the new buildings was to be fixed later.

Thereafter, on 29 October 2007, a corrigendum to the letter was issued stating that the permission granted would be subject to approval of the Board. Although the Board decided against the grant of permission to construction of new buildings, HOC did not withdraw its letter and unauthorizedly allowed MES to construct new buildings over approximately 1 acre of vacant land in the educational complex.

Audit further observed that there was considerable delay in fixing of lease rent in November 2011. The rent fixed was ₹ 1.73 crore per annum from September 2010 onwards and rent for academic year 2009-10 for the professional courses started during construction period was 50 per cent of ₹ 1.73 crore i.e. ₹ 86 lakh per annum from June 2009 to August 2010. Rent fixed by HOC was disputed (November 2011) by MES on various grounds and the latter did not pay the lease rent of ₹ 6.54 crore (for the period from June 2009 to March 2014) so far (March 2014).

In addition, HOC allotted its vacant residential quarters to be used by MES as hostel. According to the tender issued by HOC, residential accommodation was to be provided for the teaching/non-teaching staff in vacant quarters. However, while entering into lease agreement, HOC permitted MES to start residential school and sports academy in the existing school building and allotment of residential accommodation to staff and students subject to availability at prevailing rates. Accordingly, on a request by MES, HOC allotted 56 residential quarters (covering about 27640 sq. ft) outside the school campus at rates being charged from others who hired quarters from HOC for residential purposes. The Management failed to gain advantage from the commercial exploitation of the vacant quarters by MES for the latter's utilization as hostel for its students.

The Ministry, based on a complaint, directed (December 2011) HOC to review the entire arrangement and if required, to revoke the lease agreement with MES. Accordingly, the Board of Directors constituted (March 2012) a Board level sub-committee to go into the entire issue including scrutiny of Board papers to determine whether the decision of the then CMD were duly authorised by the Board. The Ministry (October 2012) again expressed concern on inaction of the Board and sought final report by 16 November 2012. The sub-committee of the Board (June 2013) decided that the final decision would be taken after conclusion of the departmental enquiry proposed by the Ministry. Neither the HOC Management nor the Ministry had taken any decision despite the lapse of two years.

HOC stated (December 2013) that as there was no space available in the old buildings of HOC School for conduct of degree/professional courses, MES was required to construct the new buildings for the same as per the norms of AICTE and UGC, within the existing premises of the educational complex of HOC. It was further stated that the Company did not lease its land to MES but only leased buildings/premises. The Company saved ₹ 19 lakh per month (₹ 2.28 crore per annum) which would have otherwise been incurred by HOC in running the school.

The reply is not acceptable as allowing MES to construct new buildings in an area admeasuring about 1 acre in the educational complex, amounted to leasing of land to MES. Also the contention that the Company made a saving of ₹ 19 lakh per month is not relevant as the arrangement was as per the agreement with MES, which was finalised through tender.

The Ministry, in its reply (January 2014), endorsed the views of HOC that there were no irregularities in the arrangements with MES. However, it directed HOC (December 2011) to get the matter probed and decided (October 2012) to conduct a departmental enquiry. Thus, the stance of Ministry was self-contradictory.

HOC school had 1267 students prior to transfer of the management to MES. After the transfer of management, it had (October 2013) 926 school students and 20 new engineering/management courses catering to 3409 college students. The constructed area in the educational complex increased from 1.308 acres prior to transfer to 2.301 acres. Thus, the transfer of management of HOC school gradually turned into a private commercial venture by MES, due to extension of various irregular and unauthorised facilities by HOC Management. Further, HOC could not even recover lease rent of ₹ 6.54 crore for the period from June 2009 to March 2014.

Rashtriya Chemicals and Fertilisers Limited

2.2 Blocking up of funds

Blocking up of ₹ 52 crore and operational loss of ₹ 12.92 crore due to inadequate assessment of project viability

Rashtriya Chemicals and Fertilizers Limited (RCF)'s Phosphoric Acid Plant of 100 metric tonnes per day capacity at Trombay evicts byproduct phospho gypsum (gypsum) at the rate of 4.30 metric tonnes for the production of each tonne of Phosphoric Acid. Rapid Building System Private Limited (RBS), Australia approached (November 2004) RCF with an innovative technology to manufacture high quality plaster and load bearing panels, etc. from gypsum. A Memorandum of Understanding was signed (October 2005) between RCF and RBS for the Rapidwall[*] project.

The Board of RCF approved (March 2006) 'Rapidwall' project at a cost of ₹ 75.70 crore which was revised (August 2010) to ₹ 81.10 crore. The project was envisaged to produce 14 lakh square meters of 'Rapidwall', 23,000 metric tons of wall plaster and 6,000 metric tons of high quality wall putty per year. The project was expected to generate IRR of 19.84 *per cent* with a payback period of 4.61 years.

RCF entered (May 2007) into an agreement with RBS for a Rapid Flow Calciner Plant and Rapidwall Plant including general arrangement and layout, drawings and technology in the form of equipment technical manuals, drawings for maintenance purpose, etc. at a cost of Australian Dollars 92,81,400 (₹ 30.80 crore at an exchange rate of 1 Aus $ = ₹ 33.19 in May 2007). The project commenced in May 2007 and RCF started production in March 2010. Total cost incurred on the project was ₹ 82.30 crore.

The Company could not attain the full utilisation of capacity. Details of production from the plant during the years 2010-11 to 2013-14 (upto October 2013) are given below:

[*] ***Rapidwall is an environmental friendly load bearing, low cost pre fabricated plaster and glass fibre reinforced walling system with broad construction applications***

Product	Unit	Annual capacity	Actual Production			
			2010-11*	2011-12	2012-13	2013-14
Wall Panel	Square Meter	14,00,000	10,944.00 (0.78)	12,024.00 (0.86)	6,156.00 (0.44)	4428.00 (0.32)
Wall Plaster	Metric Ton	23,000	864.55 (3.76)	2047.20 (8.90)	8,153.55 (35.45)	4309.50 (18.74)
Wall Putty	Metric Ton	6,000	NIL	3	NIL	NIL

From March 2010. Figures in brackets indicate percentage utilisation

Due to low capacity utilisation, the cost of production was very high and the Company incurred a loss of ₹ 12.92 crore after taking into consideration anticipated loss on the stock remaining to be sold. The Company did not recover even the variable cost as total realisation was ₹ 9.63 crore against the variable cost of production of ₹ 11.91 crore. The Company was finding it difficult to sell its products in the market and hence it was producing only very little quantity of wall panels and plaster and there was no production of wall putty.

Examination in Audit revealed that there were several critical factors which the Company did not consider before taking up the project.

Risk factor	Subsequent events
Quality of products was dependent on following raw material parameters: Gypsum purity : >90 *per cent* Moisture content : < 20 *per cent* Level of Phosphorous Pentoxide (P_2O_5) : Maximum 0.05 *per cent*	The raw material parameters could be met only if the rock phosphate (raw material for phosphoric acid) was of certain quality. When RCF changed its source (overseas supplier) of rock phosphate, the raw material parameters also changed to: Gypsum purity : <90 *per cent* Moisture content: 26 to 28 *per cent.* Level of P_2O_5: ranged between 0.25 *per cent* and 0.60 *per cent*.
Rapidwall technology was new to the country and the builders, civil engineers and architects were not having sufficient knowledge about the product. The size of the Rapid wall was 2.85 x 12 meters. The loading and unloading of Rapidwalls required skilled labour, hydraulic cranes, long carriers for transportation, etc. It also required training of masonry workers.	The Company, in order to overcome the lack of expertise, entered into a joint venture with HM Consortium (M/s. Hiranandani Constructions Pvt. Ltd. and M/s. Mahimtura Consultants Private Limited) to market products. However, this arrangement did not address the issue of acceptability of products. The JV experiment was not successful as the product was not accepted by the market. The JV was wound up.

As the investment required was huge, the Company should have considered above risks.

The Company stated (October 2013) that:

- It was predominantly using rock phosphate procured from Jordan as raw material for Phosphoric Acid. The quality of byproduct gypsum was therefore based on this rock. The gypsum thus produced was tested by technology supplier and recommended as suitable for manufacture of wall panels and other plaster products. Since rock from Jordan only was being used, gypsum produced by rock from other sources was not envisaged and was not available for testing. Due to non-technical and compelling commercial reasons, rock phosphate from sources other than Jordan was procured. Although the alternate rock was suitable for its primary use in the manufacture of complex fertilizers, the quality of byproduct gypsum thus produced was found to be adversely influencing consistency of Rapidwall panel quality. Such changes in gypsum quality and consequent panel quality due to change in rock source could not be foreseen.

- The joint venture for marketing of Rapidwall products was formed with renowned companies of builders and structural engineers. The joint venture partners carried out field tests and developed their own methodology for construction with wall panels. However, the joint venture was wound up, among other reasons, as the partners demanded much higher discounts than was affordable.

- Training sessions were arranged for the civil engineers and architects of joint venture partners. On site demonstration and training for masonry workers and labour engaged by builder were organised.

- Acceptance of the product in the market was established by a market survey carried out by AC Nielson-ORG Marg, a renowned consultancy firm prior to the implementation of the project and was positive in all respects.

- Prior to implementation of the project, a two storey residential bungalow was constructed in the Company's township with wall panels imported from technology supplier in Australia. To witness the construction of the building, workshops were organised where large number of builders and architects participated and all of them expressed their desire to use the product in their projects.

While endorsing (February 2014) the reply furnished, the Ministry stated that the facility for wall plaster costing about ₹ 30 crore was in operation and generating revenue and the blockage on funds was approximately ₹ 52 crore only. It further stated that:

- The Company has provided for impairment loss of ₹ 48.74 crore in compliance of Accounting Standards which could be reversed in subsequent years based on improved production/ sales/cash inflows.

- The Company had taken decision with certain amount of business risk to convert a waste byproduct into a durable and cost effective alternative to costlier and

scarce cement, sand and water, demand for which was expected to grow in coming years and furnished details of future plan of action.

The reply of the Company/Ministry is not acceptable as:

- The Company tested suitability of only one source of rock phosphate. It should have considered other sources of rock phosphate and found out suitability as depending on only one source had an element of risk involved, which was proved right after the plant was set up;

- The Company could not even achieve one *per cent* of its installed capacity of the main product, wall panel, in the three years of the plant's operation and the Company could sell only 30 *per cent* of the quantity produced;

- The future plan made by the Company also provided for production of only 7.71 and 15.43 *per cent* of the installed capacity of wall panel and 65 and 65 *per cent* of the installed capacity of wall plaster during 2014-15 and 2015-16 respectively;

- Annual profit expected from the project was ₹ 10.78 crore, out of which ₹ 5.81 crore was from the sale of wall putty. The production of wall putty was only 3 MT during 2011-12 and there was no production in other years. As there was no production and sale of wall putty, which was expected to generate more than 50 *per cent* profit of the project, the viability of the project became doubtful;

- The project was expected to generate IRR of 19.84 *per cent* with a payback period of 4.61 years. However, operation of the Rapidwall plant from March 2010 to October 2013 resulted in a loss of ₹12.92 crore;

- The Company provided for impairment loss of ₹ 48.74 crore for the project during 2011-12 and 2012-13 since the expected value in use was lower than the carrying amount. This indicated that the Company was not confident of future prospects of the project. In view of the continued under utilisation of capacity and loss during 2013-14, the Company would have to provide further impairment loss during 2013-14 and reversal of impairment loss already provided is uncertain.

Thus, inadequate assessment of risk factors of the project led to the Company investing in a non-viable project resulting in blocking up of funds of ₹ 52 crore, which might be a loss to the Company. Additionally, it also suffered operational loss of ₹ 12.92 crore.