

## **CHAPTER I: INTRODUCTION**

### **1.1 About the Report**

The report relates to matters arising from audit of the financial transactions of Ministry of Defence and its following organisations:

- Indian Navy (IN)
- Indian Coast Guard (ICG)
- Defence Research and Development (R & D) Organisation of Ministry of Defence and its laboratories dedicated primarily to IN
- Mazagon Dock Limited, Mumbai (MDL)
- Garden Reach Shipbuilders & Engineers Limited, Kolkata (GRSE)
- Goa Shipyard Limited, Goa (GSL)
- Hindustan Shipyard Limited, Visakhapatnam (HSL)
- Defence Accounts Department dealing with IN
- Military Engineer Services (MES) dealing with IN

Office of the Principal Director of Audit, Navy [PDA (N)]<sup>1</sup>, New Delhi, along with its three branch offices at Mumbai, Vishakhapatnam and Kochi is responsible for audit of Indian Navy, Coast Guard and other related organisations. MDL, GRSE, GSL and HSL are audited by the Principal Director of Commercial Audit & Ex-officio Member Audit Board IV, Bengaluru.

There are broadly three distinct types of audit: Financial Audit, Compliance Audit and Performance Audit.

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<sup>1</sup> Previously in Mumbai.

**Financial Audit** is the review of financial statements of an entity that seeks to obtain an assurance that the financial statements are free from material misstatements and present a true and fair picture.

**Compliance Audit** scrutinises transactions relating to expenditure, receipts, assets and liabilities of the audited entities to ascertain whether the provisions of the Constitution of India, applicable laws, rules, regulations and various orders and instructions issued by the competent authorities are being complied with.

**Performance Audit** is an in-depth examination of a programme, function, operation or the management system of entity to assess whether the entity is achieving economy, efficiency and effectiveness in the employment of available resources.

## **1.2 Authority for audit**

Article 149 of the Constitution of India and the Comptroller and Auditor General's (Duties, Powers and Conditions of Service) Act 1971 and Regulations of Audit and Accounts 2007, give authority for audit and detailed methodology of audit and its reporting.

## **1.3 Planning and conduct of audit**

Audit is prioritised through an analysis and evaluation of risks so as to assess their criticality in key operating units. Expenditure incurred, operational significance, past audit results and strength of internal control are amongst the main factors which determine the severity of the risks.

Audit findings of an entity/unit are communicated through Local Test Audit Reports/Statement of Cases. The response from the audited entity is considered which may result in either settlement of the audit observation or referral to the next audit cycle for compliance. Serious irregularities are processed as draft paragraphs for inclusion in the Audit Reports which are submitted to the President of India under Article 151 of the Constitution of India, for laying them before each House of Parliament. Performance Audits are done through structured exercise by defining scope of audit, holding entry conference, sampling of units, exit conference, inclusion of feedback on draft report and issuance of final report.

#### **1.4 Profile of the audited entities**

**The Indian Navy** is headed by the Chief of Naval Staff. Naval Headquarters (NHQ) is the apex body and chief management organisation and is responsible for command, control and administration of the Indian Navy. Operational and maintenance units of Indian Navy consist of warships and submarines, dockyards, naval ship repair yards, armament and weapon equipment depots and material organisations. Indian Navy has an Aviation wing with air stations and allied repair facilities under them. Indian Navy also has overseeing teams which monitor the construction of ships and submarines at the concerned shipyards.

**The Indian Coast Guard** was created to protect the country's vast coastline and offshore wealth. The Director General, Coast Guard exercises general superintendence, direction and control of the Coast Guard. The Coast Guard has various types of patrol vessels for patrolling the coastline for illegal activities like smuggling, trespassing into Indian Maritime zones etc. Coast Guard also has an aviation wing to patrol the coastal areas and carry out Search and Rescue Mission at sea with fixed and rotary wing. The aviation wing has Coast Guard Air stations and Air Enclaves for effectively carrying out its duties in all the coastal areas.

**Defence Public Sector Undertakings:** There are four Defence Public Sector Shipyards (DPSS) viz., Mazagon Dock Limited (MDL), Garden Reach Shipbuilders & Engineers Limited (GRSE), Goa Shipyard Limited (GSL) and Hindustan Shipyard Limited (HSL) under the administrative control of the Ministry of Defence. The four shipyards are engaged in building warships and vessels of various sizes for the maritime forces of the country. The management of shipyards is vested in the Board of Directors headed by a Chairman & Managing Director who is assisted by Functional Directors. The product line of the shipyards include Inshore Patrol Vessel, Fast Patrol Vessels and Offshore Patrol Vessels besides Frigates and Anti Submarine Warfare (ASW) Corvettes (GRSE), Passenger cum Cargo Vessel, Submarines, Tugs, Corvettes and Missile Boats (MDL), pontoons (GSL) and Tugs, Dredger and Passenger Ferry/Ships (HSL). While MDL, GRSE and GSL are under the administrative control of Ministry of Defence, the administrative control of HSL was transferred from Ministry of Shipping to Ministry of Defence in February 2010.

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- i. Mazagon Dock Limited, Mumbai (MDL) is a fully owned Government of India undertaking under the administrative control of the Ministry of Defence. It is engaged in the construction of warships for the Navy and offshore structures for the ONGC. The paid up capital of MDL as on 31 March 2014 was ₹199 crore. The turnover of MDL increased from ₹2291 crore in 2012-13 to ₹2866 crore in 2013-14 *i.e. 25 per cent.*
- ii. Garden Reach Shipbuilders & Engineers Limited, Kolkata (GRSE) is a fully owned Government of India undertaking under the administrative control of the Ministry of Defence. It is engaged in ship building and ship repair. The paid up capital of GRSE as on 31 March 2014 was ₹124 crore. The turnover of GRSE increased from ₹1527 crore in 2012-13 to ₹1611 crore in 2013-14 *i.e. 6 per cent.*
- iii. Goa Shipyard Limited (GSL) is a Government of India undertaking under the administrative control of the Ministry of Defence. The major shareholders of GSL are Government of India (51 *per cent*) and MDL (47 *per cent*). It is engaged in designing and building of various classes of ships for the defence as well as the commercial sectors. The paid up capital of GSL as on 31 March 2014 was ₹29 crore. The turnover of GSL increased from ₹507 crore in 2012-13 to ₹509 crore in 2013-14.
- iv. Hindustan Shipyard Ltd, Visakhapatnam (HSL) is a fully owned Government of India undertaking under the administrative control of the Ministry of Defence. It is engaged in shipbuilding, ship repairs and submarine repairs. The paid up capital of HSL as on 31 March 2014 was ₹302 crore. The turnover of HSL decreased from ₹484 crore in 2012-13 to ₹453 crore in 2013-14 *i.e. 7 per cent*

**The Military Engineer Services (MES)** is one of the largest Government construction agencies and is headed by Engineer-in-Chief. The MES is responsible for conclusion of contracts, execution of work services and maintenance of existing buildings of the Armed Forces. It works under the Engineer-in-Chief Branch of Army Headquarters.

**The Defence Research and Development Organisation** undertakes design and development of weapon systems and equipment in accordance with the

expressed needs and qualitative requirements laid down by the services. Certain laboratories are dedicated exclusively to Navy like the Naval Science and Technological Laboratory (NSTL), Naval Physical and Oceanographic Laboratory (NPOL) and Naval Materials Research Laboratory (NMRL). These organisations also render scientific advice to the Service Headquarters. They work under the Department of Defence Research and Development of the Ministry of Defence.

**The Defence Accounts Department** headed by the Controller General of Defence Accounts is responsible for accounting of defence services receipts and expenditure as well as defence pensions and also provides services in terms of financial advice.

## **1.5 Defence Budget**

The Defence budget is broadly categorised under Revenue and Capital expenditure. While Revenue expenditure includes pay and allowances, stores, transportation and work services etc., Capital expenditure covers expenditure on acquisition of new ships, submarines, weapons, ammunition and replacement of obsolete stores, construction work.

The Defence expenditure increased from ₹1,87,469 crore in 2012-13 to ₹2,09,789 crore in 2013-14 *i.e.* by 11.91 *per cent.* The share of Indian Navy in the total expenditure on Defence Services in 2013-14 was ₹33,831 crore *i.e.* 16.13 *per cent.*

## **1.6 Budget and Expenditure of Navy**

The summarised position of appropriation and expenditure during 2009-10 to 2013-14 in respect of Indian Navy is reflected in the Table below:

**Table 1.1: Appropriation and Expenditure**

(₹ in crore)

Year	Description	Capital		Revenue	
		Voted	Charged	Voted	Charged
2009-10	Final Grant	13,284.33	74.87	9,435.70	4.23
	Actual Expenditure	13,272.36	75.45	9,586.21	0.88
	Total Excess /Savings(+)/(-)	(-) 11.37	(+) 0.58	(+)150.51	(-)3.35
2010-11	Final Grant	16,898.32	6.95	10,002.52	7.45
	Actual Expenditure	17,136.09	4.08	10,141.36	3.33
	Total Excess/Savings(+)/(-)	(+)237.77	(-)2.87	(+)138.84	(-)4.12
2011-12	Final Grant	17,920.69	1.45	12,335.02	11.91
	Actual Expenditure	19,210.86	0.66	12,057.82	0.91
	Total Excess/Savings(+)/(-)	(+)1,290.17	(-)0.79	(-)277.20	(-)11.00
2012-13	Final Grant	17,057.74	8.68	12,741.82	13.20
	Actual Expenditure	17,753.62	6.26	12,095.95	22.77
	Total Excess/Savings(+)/(-)	(+)695.88	(-)2.42	(-)645.87	(+)9.57
2013-14	Final Grant	19,378.62	7.00	13,331.12	32.82
	Actual Expenditure	20,351.20	7.65	13,451.52	20.73
	Total Excess/Savings (+)/(-)	(+)972.58	(+)0.65	(+)120.40	(-)12.09

Source: Year-wise Appropriation Accounts of Defence Services.

An analysis of the Appropriation Accounts, Defence Services for each of the five years had been included in the Report of the Comptroller and Auditor General of India for the relevant years, Union Government – Accounts of the Union Government.

### 1.6.1 Navy Expenditure

The total expenditure incurred by the Indian Navy during 2009-2014 ranged between 15.73 and 17.78 *per cent* of the total Defence expenditure. In the year 2013-14, the expenditure of Indian Navy rose by 13.23 *per cent* from ₹29,879 crore to ₹33,831 crore as compared to the previous year.

A broad summary of expenditure of Indian Navy is given in the Table below:

**Table 1.2: Expenditure of Indian Navy**

(₹ in crore)

Year	Total	Percentage change over previous year	As a percentage of total Defence Expenditure	Revenue Expenditure	Capital Expenditure
2009-10	22,935	(+)31.76	15.73	9,587	13,348
2010-11	27,285	(+)18.96	17.19	10,145	17,140
2011-12	31,270	(+)14.60	17.78	12,059	19,211
2012-13	29,879	(-) 4.45	15.94	12,119	17,760
2013-14	33,831	(+)13.23	16.13	13,472	20,359

Source: Year-wise Appropriation Accounts of Defence Services

### 1.6.2 Capital Expenditure

The Capital expenditure of the Indian Navy rose by 14.63 per cent during five year period from 2009-10 to 2013-14. In absolute terms, Capital expenditure increased from ₹13,348 crore in 2009-10 to ₹20,359 crore in 2013-14.

The Capital Expenditure of Indian Navy was mainly incurred on acquisition of naval fleet and aircraft and aero engines. The average annual distribution of expenditure over different categories for the last five years (2009-10 to 2013-14) for Indian Navy is depicted in the Table below:

**Table 1.3: Capital Expenditure of Indian Navy**

(₹ in crore)

Year	Naval Fleet	Naval Dockyard	Aircraft and Aero-Engine	Construction Works	Other Equipments <sup>2</sup>	Others	Total
<b>2009-10</b>	7,460 (56%)	720 (5%)	3,603 (27%)	308 (2%)	868 (7%)	389 (3%)	<b>13,348</b>
<b>2010-11</b>	10,620 (62%)	720 (4%)	3,187 (19%)	637 (4%)	1,578 (9%)	398 (2%)	<b>17,140</b>
<b>2011-12</b>	10,320 (54%)	648 (3%)	4,336 (23%)	515 (3%)	2,583 (13%)	809 (4%)	<b>19,211</b>
<b>2012-13</b>	11,074 (62%)	752 (4%)	1,695 (10%)	527 (3%)	2,773 (16%)	939 (5%)	<b>17,760</b>
<b>2013-14</b>	8,151 (40%)	633 (3%)	7,746 (38%)	516 (3%)	2,630 (13%)	683 (3%)	<b>20,359</b>

Source: Year-wise Appropriation Accounts of Defence Services.

<sup>2</sup> Other equipments include Electrical/Electronics, Weapon Equipments, Space and Satellite equipments, Electronic Warfare equipments etc.

During the year 2013-14, a significant portion (78.08 per cent) of Capital expenditure was incurred on procurement of aircraft and aero engine and naval fleet. About 12.92 per cent was spent on other equipment and 2.54 per cent was spent on construction activities.

### 1.6.3 Revenue Expenditure

During 2009-10 to 2013-14, Revenue expenditure of the Indian Navy increased by 40.52 per cent from ₹9,587 crore in 2009-10 to ₹13,472 crore in 2013-14. The Revenue expenditure of the Indian Navy was mainly incurred on pay and allowances and stores. The distribution of expenditure over different categories of Revenue expenditure for the last five years is depicted below:

**Table 1.4: Revenue Expenditure of Indian Navy**

(₹ in crore)

Year	Pay and allow- Ances	Stores	Works	Trans- port	Repair/ Refit	Others	Total
2009-10	3,971 (41%)	2,957 (31%)	645 (7%)	233 (2%)	572 (6%)	1,209 (13%)	9,587
2010-11	3,731 (37%)	3,437 (34%)	701 (7%)	288 (2%)	606 (6%)	1,382 (14%)	10,145
2011-12	4,508 (37%)	4,173 (35%)	763 (6%)	353 (3%)	768 (6%)	1,494 (12%)	12,059
2012-13	4,697 (39%)	3,982 (33%)	760 (6%)	380 (3%)	654 (5%)	1,646 (14%)	12,119
2013-14	5,085 (38%)	4,619 (34%)	1,031 (8%)	347 (3%)	593 (4%)	1,797 (13%)	13,472

Source: Year-wise Appropriation Accounts of Defence Services

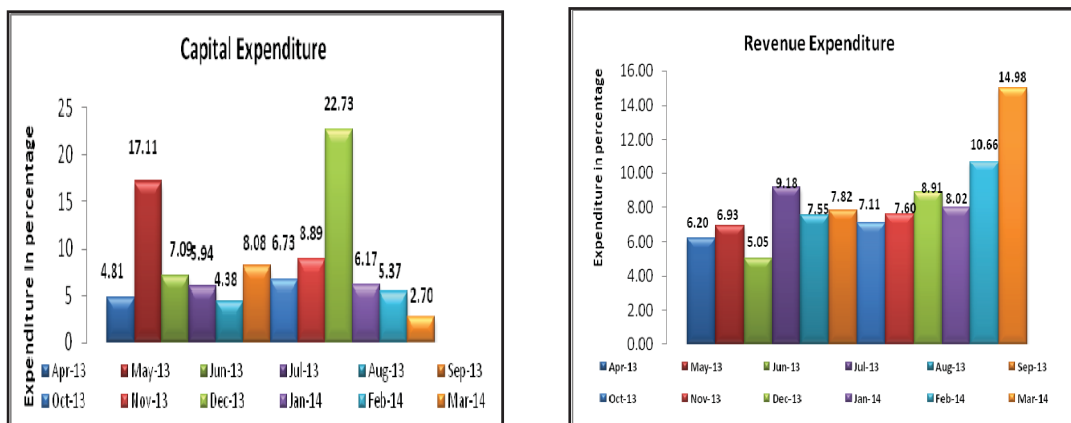
### 1.6.4 Flow of Expenditure of Indian Navy during the year

The flow of Capital and Revenue<sup>3</sup> expenditure during 2013-14 is indicated as below:

<sup>3</sup> The total Revenue Expenditure is exclusive of ₹24.99 crore, which has been expended by Ministry of Information and Broadcasting, on behalf of Indian Navy and the monthly break up was not furnished to audit.



**Figure: 1.1 Flow of Expenditure of Indian Navy during 2013-14**



Source: Information provided by Controller General of Defence Accounts

Scrutiny of flow of expenditure revealed that the Revenue expenditure of Indian Navy in March 2014 was 14.98 per cent which was within the limit of 15 per cent prescribed by the Ministry of Finance.

## 1.7 Budget and Expenditure of Coast Guard

The budget of the Coast Guard forms part of the Grant of the Ministry of Defence. The amount provided for revenue and capital are under the Major Head 2037- 'Customs (Preventive and other functions- Coast Guard Organisations)' and 4047- 'Capital Outlay of Fiscal Services, Customs (Coast Guard Organisation)' respectively. Separate Major heads for Coast Guard expenditure under Ministry of Defence have not been opened.

### 1.7.1 Expenditure of Coast Guard

The total expenditure of Coast Guard ranged between ₹1,529.15 crore and ₹2,510.06 crore from 2009-10 to 2013-14. The expenditure dropped by 15.70 per cent in 2013-14 as compared to the previous year.

A broad summary of allotment and expenditure is given in the Table below:

**Table 1.5: Expenditure of Coast Guard**

(₹ in crore)

Year	Budget Estimates			Final Grant/ Appropriation	Expenditure		
	Capital	Revenue	Total		Capital	Revenue	Total
2009-10	1,300.42	604.37	1,904.79	1,525.72	908.05	621.10	1,529.15
2010-11	1,100.00	882.45	1,982.45	2,016.06	1,200.78	813.57	2,014.36
2011-12	1,600.00	890.94	2,490.94	2,532.88	1,575.38	925.84	2,501.22
2012-13	1,620.00	906.63	2,526.63	2,525.41	1,564.71	945.35	2,510.06
2013-14	1,775.00	1,054.81	2,829.81	2,078.15	1,070.22	1,047.50	2,117.72

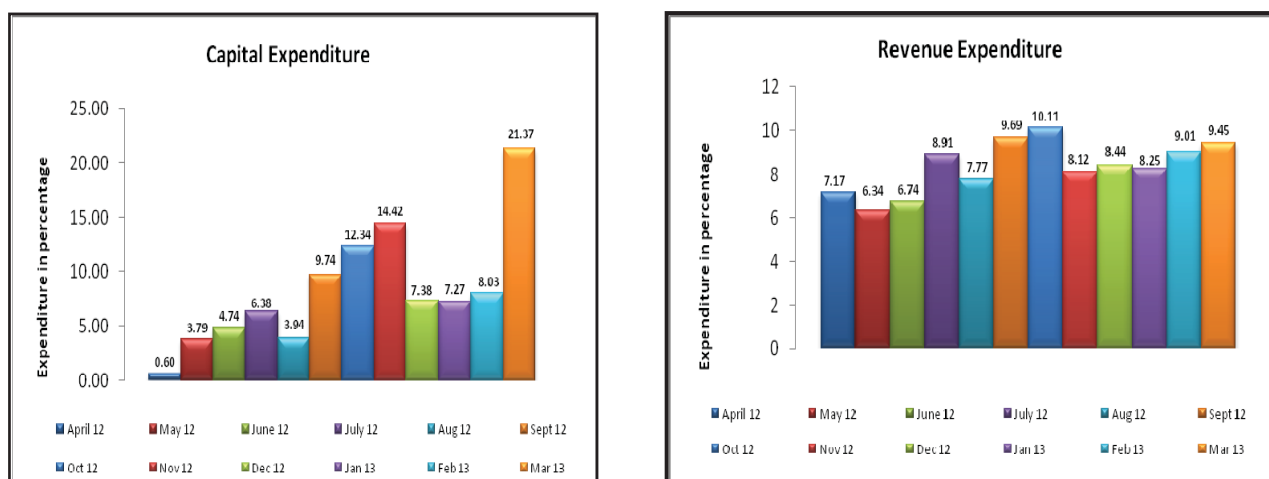
(Source: Information provided by Coast Guard Headquarters)

The Capital expenditure of Coast Guard decreased by nearly 31.60 per cent from ₹1,564.71 crore to ₹1,070.22 crore in the year 2013-14 as compared to the previous year. The Revenue expenditure of Coast Guard increased by nearly 10.81 per cent from ₹945.35 crore to ₹1,047.50 crore in the year 2013-14 as compared to the previous year.

### 1.7.2 Flow of Expenditure during the year

Audit examined flow of Capital and Revenue expenditure during the year 2013-14, which is indicated as below:

**Figure: 1.2 Flow of Expenditure of Coast Guard during 2013-14**



(Source: Information provided by Coast Guard Headquarters)

Scrutiny of expenditure revealed that a substantial portion of Capital expenditure was incurred by the Coast Guard in the month of March 2014. The Coast Guard incurred about 21.37 *per cent* of the Capital expenditure in the month of March 2014 alone and 36.67 *per cent* of the Capital expenditure in the last quarter which was not within the limit of 15 *per cent* for the month of March and 33 *per cent* for the last quarter as prescribed by the Ministry of Finance. However, the Revenue expenditure was within the limits prescribed by Ministry of Finance.

## 1.8 Receipts of the Navy and Coast Guard

The details of receipts and recoveries pertaining to the Indian Navy and Coast Guard during the last five years ending 2013-14 for the services that they provided to other organisations/departments are given in the Table below:

**Table 1.6: Revenue Receipt of Indian Navy and Coast Guard**

(₹ in crore)

Year	Receipt and Recoveries in respect of Navy	Receipt and Recoveries in respect of Coast Guard
2009-10	241.30	31.09
2010-11	165.68	13.33
2011-12	154.94	06.73
2012-13	285.07	34.41
2013-14	437.89	27.19

Source: Figures of actual receipts as given in Defence Service Estimates for each year (For Navy) and Information provided by Coast Guard Headquarters

The receipt and recoveries in respect of Navy has shown an increase of 54 *per cent* as compared to previous year, whereas the receipts and recoveries in respect of Coast Guard have shown a decline of 21 *per cent* from the previous year.

## 1.9 Response to Audit

### 1.9.1 Response of the Ministry to Draft Audit Paragraphs

On the recommendations of the Public Accounts Committee (PAC), the Ministry of Finance (Department of Expenditure) issued directions to all the Ministries in June 1960 to send their response to the Draft Audit Paragraphs proposed for inclusion in the Report of the Comptroller and Auditor General of India within six weeks.

The Draft Paragraphs proposed for inclusion in this Report were forwarded to the Secretary, Ministry of Defence between January 2015 and February 2015 through demi-official letters, drawing attention to the audit findings and requesting a response within six weeks.

Despite the instructions of the Ministry of Finance, MoD's replies to six Paragraphs out of thirteen Paragraphs included in this Report were not received as given in Annexure I. Thus, the response of the Ministry could not be included in respect of these Paragraphs.

### 1.9.2 Action Taken Note on Audit Paragraphs of earlier Reports

With a view to enforce accountability of the executive in respect of all issues dealt with, in various Audit Reports, the PAC desired that Action Taken Notes (ATNs) on all paragraphs pertaining to the Audit Reports for the year ended 31 March 1996 onwards be submitted to them, duly vetted by audit, within four months from the laying of the Report in Parliament.

Status of outstanding ATNs on Audit paragraphs relating to the Navy and Coast Guard as on 31 August 2015 is shown as under:

**Table 1.7: Status of ATN**

Status of ATN	Navy and Coast Guard	Defence Shipyards
Audit Paragraphs/ Reports on which ATNs have not been submitted by the Ministry even for the first time	6	1
Audit Paragraphs/ Reports on which revised ATNs are awaited.	15	2