CHAPTER III: INDIAN NAVY

3.1 Avoidable expenditure of ₹20.80 crore on Medium Refit cum Cadet Training Ship conversion of INS Sujata due to improper evaluation of bids

Navy accepted (February 2009) the unsolicited bids of M/s WISL, Mumbai (*i.e.* a shipyard) for conversion of Indian Naval Ship (INS) Sujata as Cadet Training Ship, on the assumption that it was a merged entity of M/s ABG, Gujarat (another shipyard) to whom Request for Proposal (RFP) was issued (November 2008). Further, rejection (October 2009) of the bid of M/s WISL in spite of provisions for consideration of unsolicited bids in the Defence Procurement Manual and consequent re-issue (January 2010) of RFP led to a delay of 18 months in conclusion of contract and avoidable expenditure of ₹20.80 crore.

Ministry of Defence (Ministry) accorded Approval in Principle (AIP) (November 2008) for conversion of Indian Naval Ship (INS) Sujata[1], commissioned in November 1993, as Cadet Training Ship (CTS) during its Medium Refit (MR). The MR was to be offloaded to a suitable Public Sector Undertaking (PSU)/Commercial Ship Repair Yard on Limited Tender Enquiry basis, at an estimated cost of ₹80.22 crore for a duration of 12 months, with effect from March 2009. The Request for Proposal (RFP) for undertaking the work of MR-cum-CTS conversion was issued by Naval Ship Repair Yard (NSRY), Kochi (K) to seven firms[2] (November 2008) including M/s ABG Shipyard Limited, Mumbai.

[1] INS Sujata is a Sukanya class Offshore Patrol Vessel (OPV) of Indian Navy

[2] (1) M/s Cochin Shipyard Ltd. (CSL), Kochi, (2) M/s Hindustan Shipyard Ltd. (HSL), Visakhapatnam, (3) M/s Garden Reach Shipbuilders & Engineers (GRSE), Kolkata, (4) M/s Bharati Shipyard Ltd., Mumbai, (5) M/s ABG Shipyard Ltd. (ABG), Mumbai, (6) M/s Mazagon Dock Ltd. (MDL), Mumbai and (7) M/s Goa Shipyard Ltd. (GSL), Goa

In response to RFP, quotes were received (February 2009) from M/s HSL, M/s CSL and M/s Western India Shipyard Ltd (WISL), to whom RFP was not issued. M/s ABG, to whom RFP was issued, in its letter (February 2009), requested Navy to forward all correspondence related to refit to M/s WISL, who would undertake the required activities on their behalf. The quote of M/s WISL was accepted by Ministry with the understanding that M/s WISL was a part of M/s ABG as a merged entity. The Technical Evaluation Committee (TEC) found (February 2009) all the three shipyards (including M/s WISL) technically competent for undertaking the MR and CTS conversion of INS Sujata. The commercial bids were opened by the Tender Opening Committee (TOC) (April 2009) and the quote of M/s WISL at ₹55.71 crore was found to be the lowest followed by the quote of M/s HSL at ₹55.85 crore. Thereafter, Contract Negotiation Committee (CNC), in its meeting (July 2009) sought clarification as to whether M/s WISL was a division of M/s ABG or a separate shipyard. Navy, after obtaining clarification from M/s ABG (July 2009) intimated (October 2009) that the merger was subjudice before Bombay High Court. CNC recommended (October 2009) that the case for offloading the refit of INS Sujata be re-tendered from RFP stage.

RFP was re-issued to the same seven shipyards in January 2010 and the quotes were received from three firms viz., M/s HSL, M/s CSL and M/s ABG. The price quoted by the firms were evaluated by CNC in June 2010 and the price of ₹77.26 crore quoted by M/s ABG was found to be the lowest. During negotiations, the firm offered (July 2010) discount and quoted a final price of ₹73.85 crore. CNC recommended (July 2010) conclusion of contract with M/s ABG at a cost of ₹73.85 crore, which was approved by the Competent Financial Authority (September 2010). As per the contract concluded (October 2010) with M/s ABG, refit was scheduled to be completed by September 2011. However, it was finally completed in August 2012, after a delay of 325 days and incurring an expenditure of ₹76.51 crore including Growth of Work.

We observed (July 2014) that instead of cancelling the procurement process after opening of commercial bids and re-tendering the case from RFP stage, Navy had the option of rejecting the bid of M/s WISL and concluding the contract with M/s HSL, who was the second lowest bidder at a quoted price of ₹55.85 crore, which was just ₹0.14 crore higher than M/s WISL.

In reply to the audit observation (July 2014), Ministry replied (April 2015) that the quote of M/s WISL was accepted on the basis of the authorisation letter of M/s ABG and even if the bids had been submitted without authorisation, the same could not be rejected as per the provisions of Defence Procurement Manual-2009 (DPM), which provided for acceptance of unsolicited bids by technically compliant vendors.

The reply of Ministry is contradictory to its own actions, as Navy, on their own accord, first accepted the bid of M/s WISL on assumption that it was a merged entity of M/s ABG and later rejected the same. Further, Navy retendered (November 2008) the process instead of accepting the bid of M/s WISL as an unsolicited bid, as per the provisions of DPM, quoted in its reply.

The Ministry further stated that the initial quote of M/s WISL was ₹63.47 crore after loading of the Defect Lists (DLs) which were not quoted by the yard in its initial quote.

This reply of the Ministry is not based on facts as the Comparative Statement of Tenders vetted by MoD (Fin) included cost of certain unquoted DLs of all the three yards with the highest quoted cost to equate all the yards for the purpose of determination of L-1.

Thus, improper assumption by Navy in considering M/s WISL to be a merged entity of M/s ABG and later rejecting the bid instead of considering the bid of M/s WISL as an unsolicited bid, as stipulated in DPM, not only led to a delay of 18 months in conclusion of contract, but also an avoidable expenditure of ₹20.80 crore[3].

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[3] ₹76.51 crore (Actual cost of Refit) - ₹55.71crore (Cost as per quote of M/s WISL) = ₹20.80 crore

3.2 Over provisioning of Roller Steel

Failure of the Indian Navy to follow the extant system driven Review Programme to determine the Procurement Quantities of Roller Steel coupled with the fact that there was reduction in the holding of Sea Harrier aircraft, during the last decade led to the over provisioning and an avoidable expenditure of ₹2.54 crore. Further, due to imminent scheduled decommissioning of aircraft fleet in December 2015, the prospect of utilisation of this over-provisioned quantity of Roller Steel lying in stocks is unlikely.

The relevant Naval Instruction stipulates that with the introduction of Integrated Logistics Management System (ILMS) the review process of the entire Naval Inventory is to be carried out on an annual basis, as per centrally approved and promulgated Annual Review Plan (ARP). During the Review Process all the Review Planning factors are taken into account in a system driven Review Programme on ILMS to generate Procurement Quantities (PQ).

Roller Steel is a component of bearing used in Constant Speed Drive Unit (CSDU) of Sea Harrier aircraft. A total quantity of 22 Roller Steel is fitted in each CSDU. The Indian Navy has an inventory of 11 Sea Harrier Aircraft which are fitted with 22 CSDUs and hence a total of 484 Roller Steel is fitted on the entire Sea Harrier fleet.

Based on a requirement projected (October 2010) by Naval Aircraft Yard (Navy) Kochi {NAY (K)}, Directorate of Naval Air Materials, Integrated Headquarters, Ministry of Defence (Navy) {DNAM, IHQ MoD (Navy)} placed (November 2011) an order on M/s Aviation and Defence Spares, UK (ADS) for 17 items of spares at a total cost of $779,545.325 (₹3.48 crore[4]) which *inter alia* included 2000 Roller Steel costing $671,000.00 (₹3 crore). The firm supplied 16 items of spares, including quantity 2000 Roller Steel, in April 2012 and balance one item of spare in November 2012.

[4] 1 US $ = ₹44.70

We noticed (July 2013) that the Indian Navy did not follow the extant system driven Review Programme on ILMS to generate Procurement Quantities (PQs) and the PQs of 2000 Roller Steel was decided upon as the quantity 2500 Roller Steel, projected earlier in 2007, had not materialised. Besides, while freezing the requirement (October 2010), DNAM, IHQ MoD (Navy) overlooked the following:

- During the last decade *i.e.* from December 2001 to October 2010, only 484 Roller Steel had been consumed.
- There was a high attrition rate of Sea Harrier fleet due to accidents between December 2001 and October 2010. While the Indian Navy had an inventory of 19 Sea Harrier aircraft in December 2001, which reduced to only 12 Sea Harrier aircraft by October 2010.

DNAM, IHQ MoD (Navy), stated (August 2013) that 2000 Roller Steel had been procured to cater for future "Worst Case Scenario" requirements, wherein, increasing number of CSDUs may need to be turned around and at that time procurement of the item might not be possible.

The contention of IHQ MoD (Navy) is not tenable due to the following reasons:

- The term "Worst Case Scenario", is not mentioned in any provisioning / procurement manuals or guidelines notified by either the Ministry of Defence or the Indian Navy as a review planning factor for generating PQs.
- There is no documentary evidence available on record to suggest that any survey of CSDUs was carried out by the Indian Navy to ascertain their physical / functional condition.
- Even considering the "Worst Case Scenario" argument put forth by IHQ MoD (Navy) *i.e.* all the Roller Steel fitted on entire Sea Harrier fleet become repairable simultaneously/ in one go, only 484 Roller Steel would be required by the Indian Navy. Further, once all the Roller Steel fitted onboard is replaced with new ones, there is a remote chance of these going bad/ faulty in immediate future.
- The Indian Navy was aware at the time of raising the indent in October 2010 that the Sea Harrier fleet was planned for likely de-induction by

2012. The de-induction of Sea Harrier was later, (November 2012), rescheduled by IHQ MoD (Navy) to December 2015.

Principal Director Air Logistics Support, IHQ MoD (Navy) agreed (September 2013) with the facts and accepted that there was an over provisioning of the item.

In response to an audit query raised (June 2015), IHQ MoD (Navy) intimated (August 2015) that out of quantity 2000 Roller Steel contracted in November 2011, only quantity 308 Roller Steel had been utilised till July 2015 for undertaking repairs of 14 CSDUs.

Thus, the likelihood of utilising the balance stock of 1692 Roller Steel, valuing USD 567,666 (₹2.54 crore)[5], appears remote by December 2015 *i.e.* the scheduled de-induction of Sea Harrier aircraft.

The Ministry of Defence, in response to Audit Paragraph stated in July 2015, that the cardinal points regarding expenditure incurred on procurement of 2000 Roller Steel needs to be appreciated in the following light:

(a) The suppliers are fully aware of the obsolescence and criticality of the items being sought by the Indian Navy for its Sea Harrier fleet and quote exorbitant cost for the items to extract maximum commercial gains. There is no fixed basis for assessing the variation in the cost of spares quoted by the vendors and hence it cannot be reasonably predicted. Many a times buying an item at an exorbitant cost from a vendor remains the only option for the Indian Navy to sustain Sea Harrier fleet operations, since the Indian Navy is the only operator of these aircraft in the world;

(b) With sudden demand of an item in increased quantity, procuring the item in increased quantity with economical unit cost, while maintaining adequate stock would serve as insurance spares and prevent the item from becoming a “Critically Required Item” or grounding of aircraft in future;

(c) Adequate quantity of the item available in stock would also prevent the possibility of having to procure this item compulsorily at an exorbitant price in future to meet the critical or Aircraft On Ground (AOG) requirements;

[5] @ 1 USD = ₹44.70

(d) In order to obviate the above mentioned factors; prudent inventory control norms would mandate procurement of the item in increased quantity and economical unit case in one attempt taking into account worst case situation to extract maximum cost benefit; and

(e) L-1 firm had quoted the rates, with the condition that they were willing to supply the item, provided a Minimum Order Quantity (MOQ) of 2000 Roller Steel is included in the Supply Order.

The reply of the Ministry is not acceptable because the Review Process for generating Procurement Quantities (PQs) of an item, has been notified by IHQ MoD (Navy) themselves and it takes into account all the Review Planning Factors necessary for generating PQs for normal circumstances. For emergent and operational requirements, special types of indents are raised for procurement of items with envisaged deliveries in a short span of time.

The Indian Navy neither carried out any Review Process for establishing the Procurement Quantities (PQs) of Roller Steel in October 2010 nor did it take into account the factors prevalent then and instead projected the PQs, generated for the item in 2007, for procurement.

Further, the contention of Ministry of Defence about MOQ lacks rationale because IHQ MoD (Navy) themselves in their indent raised in April 2011 and the tender enquiry floated in June 2011, had mentioned the quantity of Roller Steel at 2000. The tender enquiry also stipulated that no MOQ is to be quoted by the prospective bidders. The MOQ condition of L-1 firm was, therefore, rendered irrelevant.

Thus, failure on the part of the then DNAM, IHQ MoD (Navy) to follow the extant system driven Review Programme on ILMS to generate Procurement Quantities (PQs) of Roller Steel coupled with the fact that they overlooked the consumption pattern of Roller Steel during the previous decade, which was only 484; reduced the holding of Sea Harrier aircraft with the Indian Navy. Further, their scheduled de-induction being imminent, resulted in excess procurement of Roller Steel. The over provisioning/procurement resulted in an avoidable expenditure of ₹2.54 crore.

3.3 Extra expenditure of ₹2.43 crore incurred on procurement of spares from a foreign firm

Material Organisation, Mumbai procured spares from a foreign firm on Proprietary Article Certificate basis even though the spares were available indigenously at a much lesser cost resulting in extra expenditure of ₹2.43 crore.

The Proprietary Article Certificate (PAC) is issued to the Original Equipment Manufacturer (OEM) and items are procured on PAC basis from that particular firm, when such items are available only with those firms or their dealers. As per Defence Procurement Manual 2006 (DPM 2006) PAC bestows monopoly and obviates competition, hence, PAC status should be granted after careful consideration of all factors like fitness, availability, standardization and value for money.

Material Organisation, Mumbai [MO (MB)] raised two indents for INS Matanga in April 2007 and May 2008 for procurement of spares for Main Engine 'G8V 30/45 ATL' on Limited Tender Enquiry (LTE) basis**.** The items were required by 30 May 2007 (for indent of April 2007) and 30 June 2008 (for indent of May 2008).

Accordingly, for the indent of April 2007, tenders were floated by MO (MB) twice (September 2007 and August 2008) with the Tender Opening Date (TOD) of 12 December 2007 and 24 September 2008 respectively and both the times quotes were received only from one firm viz., M/s South Calcutta Diesel[6]. As regards indent of May 2008, tenders were floated in February 2009 with TOD of 01 April 2009. The quote received from M/s Garden Reach Shipbuilders & Engineers (GRSE, Ranchi) was not considered as it was received one day late on 02 April 2009.

In the meantime, with regard to indent of April 2007, MO (MB) intimated (July 2008) Integrated Headquarters, Ministry of Defence (Navy) {IHQ MoD (N)} that M/s GRSE had not been quoting for a large number of spares of

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[6] M/s South Calcutta Diesel is one of the sub-vendors of M/s GRSE, Ranchi.

G8V 30/45 ATL engines and the only other known source of these spares was M/s MAN Germany to whom PAC might be accorded. Accordingly, IHQ MoD (N) accorded (March 2009) PAC to M/s MAN Germany with M/s MAN Diesel India (M/s MAN) as the sole authorized representative for supply of spares for the Main Engine type G8V 30/45 ATL. PAC was initially valid for one year i.e. up to 24 March 2010 and later re-validated up to 24 April 2015.

In view of the PAC issued by IHQ MOD (Navy), further processing of the indents on LTE basis was stopped and MO (MB) floated (September 2009) two tender enquiries against the same indents on M/s MAN. MO (MB) placed (May 2012) two Purchase Orders on M/s MAN for 24 items against indent of April 2007 at a total cost of ₹1.27 crore and for 16 items against the indent of May 2008 at a total cost of ₹1.61 crore. The items under both the Purchase Orders were received between December 2012 and January 2013.

Audit scrutiny (February 2013) revealed that the price of items in the order placed (May 2012) on M/s MAN against indent of May 2008 was exorbitantly high as compared with the quoted price of M/s GRSE (April 2009). A comparison of the items procured from M/s MAN, revealed that the procurement prices of 14 out of 16 items were 55 to 5260 *per cent* higher than the price offered by M/s GRSE. The total purchase from M/s MAN was made at ₹2.23 crore whereas M/s GRSE were willing to supply the same at a cost of ₹29.75 lakh for these 14 items, resulting in excess expenditure of ₹1.93 crore.

Further, scrutiny (January 2015) revealed that even after issue of PAC, other MOs at Visakhapatnam, Karwar and Kochi were procuring these items for same type of engines of other ships from M/s GRSE and M/s South Calcutta Diesel at a much lesser price. A comparison of rates of 15 items, which were procured by other MOs during the validity of PAC, revealed an extra expenditure of ₹0.50 crore incurred by Navy on procuring from M/s MAN.

On this being pointed out (January 2015), IHQ MoD (N) stated (April 2015) that G8V 30/45 ATL engines fitted on Indian Naval Ship Matanga had become obsolete and out of production and the license agreement between the OEM i.e. M/s MAN and M/s GRSE for manufacture of engine (with 20 *per* *cent* indigenous spares and 80 *percent* supplied by M/s MAN, Germany) was terminated by M/s MAN in 1980s. As regards procurement of spares by other MOs from local sources, IHQ, MoD (Navy) stated that it was done due to urgent requirement of spares as a possible one-off measure.

The contention of IHQ is not acceptable as MO Vizag, MO Karwar and MO Kochi had placed 25 orders between May 2009 and February 2014 for purchase of more than 1000 items costing ₹11.87 crore through local sources and M/s GRSE and M/s South Calcutta Diesel were supplying spares for the engine even after cancellation of the licence by OEM i.e. M/s MAN.

The high price of spares was also justified in the reply stating that pricing of a foreign OEM cannot be compared to indigenous sources wherein old stock, quality of sub-vendors are the likely reasons for the low pricing of M/s GRSE and M/s South Calcutta Diesel. IHQ MoD (N) further cited variation of Euro as one of the reasons for high prices.

The contention of IHQ is not based on facts as the MOs at Vizag and Kochi have confirmed (April 2015) that after issue of the indigenous spares, no defects/ unsatisfactory performance had been reported by the end users. Moreover, the actual difference in price of various items ranged between 378 and 5260 *per cent*, which could not be due to variation in exchange rates. Further, PAC status to M/s MAN was accorded for complete set of spares although 20 *per cent* of those spares were being manufactured indigenously.

Thus, conferring PAC status on a foreign firm, in violation of DPM, when the same items were available indigenously at a much lesser price was not justified and thus resulted in extra expenditure of ₹2.43 crore[7].

The matter was referred to the Ministry (February 2015); reply was awaited (August 2015).

[7] ₹1.93 crore + ₹0.50 crore= ₹2.43 crore

3.4 Unfruitful expenditure of ₹2.17 crore due to improper planning and consequent offloading of nickel and chrome plating work

A project sanctioned at a cost of ₹4.58 crore was short-closed after incurring an expenditure of ₹2.17 crore, due to the unilateral action of Director General Naval Projects (Visakhapatnam) in reducing the scope of work by deleting critical items. As a result, the user, Naval Dockyard, Visakhapatnam [ND (V)] was deprived of the intended facility and had to off-load Nickel/ Chrome plating jobs to private trade.

The Electroplating Shop of ECE[8] Department at ND (V) was commissioned in 1983 for electroplating activities. A Board of Officers (BoO) recommended (November 2005) 'Augmentation of facilities in ECE Department' at a Rough Indication of Cost (RIC) of ₹4.27 crore. HQENC (V)[9] forwarded (March 2006) the Board Proceedings (BPs) to IHQ MoD (N)[10] which were approved in May 2006.

While processing the case for approval of Ministry of Defence (MoD), DGNP (V)[11] submitted the Approximate Estimates (AEs) of ₹5.43 crore after deleting 146 out of 242 items costing ₹39.58 lakhs. On scrutiny of AEs, IHQ, MoD (N) requested (July 2007) DGNP (V) to reduce the cost to enable its sanctioning under financial powers of HQENC (V). Based on the request (August 2007), ND (V) reviewed (September 2007) the requirement and recommended deletion of six items, thus reducing the quantity of two items leading to reduction of cost by ₹0.76 crore.

Thereafter, DGNP (V) modified the AEs and forwarded (October 2007) the same to HQENC (V) for sanction. However, it was only after forwarding the modified AEs to HQENC (V) that DGNP (V) provided (October

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8 ECE – Electro Chemical Engineering
9 HQENC(V) – Headquarters Eastern Naval Command, Visakhapatnam
10 IHQ MoD(N) – Integrated Headquarters Ministry of Defence, Navy
11 DGNP(V) – Director General Naval Projects, Visakhapatnam

2007) ND (V) the list of 151[12] deleted items. ND (V) observed (November 2007) that the deletion of items was not in line with BPs and the purpose of augmentation of the facility was defeated. ND (V) informed DGNP (V) (November 2007) about 10 critical/important items worth ₹12 lakh (approx) as given in Annexure II, which were not to be deleted. But DGNP (V) replied (December 2007) that it was not feasible to include the critical items at that stage, since the AEs had already been forwarded (October 2007) to the Competent Financial Authority (CFA) for approval.

HQENC (V) accorded (January 2008) Admin Approval for the subject work 'Augmentation of the ECE Department at ND (V)' at an estimated cost of ₹4.58 crore. The work, which was to be carried out by DGNP (V) and completed in 104 weeks *i.e.* by January 2010, included civil works (₹1.46 crore) and equipment portion (₹3.12 crore).

DGNP (V) requested (July 2010) ND (V) to intimate its decision on progressing the work/requirements at the earliest so that the project could be executed within the sanctioned amount. However, with no response from ND (V), DGNP (V) requested (September 2010) the former to examine the feasibility of progressing/short closing the work. ND (V) proposed (October 2010) a revised scope of work, which was not accepted by DGNP (V) as the same would result in cost escalation. Thereafter, ND (V) forwarded (July 2011) a new scope of work which was found by DGNP (V) considerably different from the original Admin Approval and the estimated expenditure for executing the new scope of work would also exceed the available funds by over ₹64 lakh. The work was short closed (November 2011) after incurring an expenditure of ₹2.17 crore (₹1.61 crore on civil works and ₹0.56 crore on procurement of laboratory equipment and furniture).

We observed (January 2014) that unilateral action by DGNP (V) in reducing the scope of work by deleting 10 critical/important items required for augmentation of facilities in ECE Department led to short-closure of the work. Besides, it was also seen (January 2014) that an

[12] Correspondence between ND(V) and DGNP(V) indicates the number of deleted items as 151 / 152. However, audit scrutiny of AEs showed the number to be 152

expenditure of ₹0.56 crore was incurred on offloading of plating work between April 2010 and January 2014.

In response to the audit observations, the Ministry while admitting the facts, stated (June 2015) that during execution of the project, certain unforeseen interfacing issues involving few of the deleted equipment arose leading to the upgraded proposal, the financial implications for which exceeded the administrative approval, leading to foreclosure of the project. The Ministry also stated that ₹0.56 crore was incurred on offloading emergent plating requirement, adding that the expenditure of ₹2.17 crore was being gainfully utilised.

The Ministry's reply regarding gainful utilisation of expenditure is not acceptable because the facility was not augmented due to non-procurement of equipment items vital for enhancement of quality and durability of plating, which were recommended by the Board. Hence, without vital equipment, utilisation of executed civil works for installation and commissioning of equipment and usage of procured lab equipment for analysis of plating solutions and effluents of the proposed facility, remained incomplete. The Ministry's reply stating that ₹0.56 crore was incurred on offloading emergent plating requirement is not tenable because expenditure on off-loading of Nickel chrome plating was of recurring nature due to absence of the facility at the Electroplating shop.

Thus, contrary to the Board's recommendations and user's requirement, unilateral action by DGNP (V) to delete critical items led to non-finalisation of the equipment package and short-closure of the work, after incurring an expenditure of ₹2.17 crore. In addition, non-availability of the intended facility also resulted in an avoidable expenditure of ₹0.56 crore on off-loading of Nickel and Chrome plating work, which was of recurring nature.

3.5 Excess procurement of naval stores worth ₹1.03 crore

Lack of due diligence on the part of Material Organisation, Visakhapatnam {MO (V)} in analysing the specification while placing the purchase order led to excess procurement of cables and resultant avoidable expenditure of ₹1.03 crore.

The Defence Procurement Manual (DPM) 2009 stipulates that specifications in terms of quantity of goods to be procured should be clearly spelt out keeping in view the specific needs of the procuring organisations.

Integrated Headquarters Ministry of Defence (Navy) {IHQ MoD (N)} approved (July 2012) a list of Base and Depot (B&D) spares for Single and Dual channel Keltron Echo Sounder (Version-3)[13]. The list included two types of cables[14] of 10 metres each.

Based on the approval of IHQ MoD(N), Headquarters Eastern Naval Command, Visakhapatnam {HQENC(V)} directed (September 2012) MO(V) to procure 07 sets of B&D spares for Single and Dual channel Keltron Echo Sounder (Version-3). Consequently, MO(V) raised (December 2012) an indent for procurement of 07 sets of B&D spares consisting of 122 types of items, which included the two types of cables of quantity 70 numbers each, from M/s Keltron, Kerala on Proprietary Article Certificate (PAC) basis.

Tender enquiry was floated (March 2013) to M/s Keltron and the firm quoted (June 2013) an amount of ₹1.65 crore for the 07 sets of B&D spares. MO (V) requested (July 2013) M/s Keltron to justify the quoted prices and also to furnish details of purchase order (PO) placed for these items by any Govt/Defence Organisation since last purchase price (LPP) of the items were not available with MO(V). The firm provided (July 2013) to MO(V) a copy of the PO of December 2012 placed by M/s Garden Reach Shipbuilders and Engineers (GRSE) on the firm for supply of B & D spares for Echo sounder (Version-3).

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13 Keltron Echo sounder Ver 3 is used to ascertain the depth of sea and helps in giving exact depth below ships' keel so as to avoid any underwater collision.

14 AWG 28-16/G/300 CABLE 16 COND 300' RIBON and AWG 28-16/6/300 CABLE 10 COND 300' RIBON

During the Naval Logistics Committee (NLC) meeting (September 2013), the firm agreed to match the rates of M/s GRSE`s order for 111 types of items and also offered one *per cent* bulk discount on the Total Order Value (TOV). MO (V) placed (December 2013) the PO on M/s Keltron for ₹1.55 crore for procurement of 07 sets of B&D spares consisting of 122 types of spares which included the two types of cables of 70 numbers each.

After inspection (March 2014) by the Naval Quality Assurance Establishment, MO (V) received 70 numbers each of both the cables and took them on charge (April 2014). Upon forwarding (May and July 2014) of bills by MO (V), the Defence Accounts Department (DAD) released (May and July 2014) payment of ₹1.55 crore to the firm for supply of 122 types of spares which involved two types of cables of 70 numbers each.

We compared (August 2014) the GRSE PO of December 2012 with the MO (V) PO of December 2013 and found that as per M/s GRSE`s order, denomination of the subject cable was mentioned in numbers, with one number equivalent to 10 metres. However, MO (V) failed to evaluate the equivalent denomination of numbers in metres and placed (December 2013) the PO for 70 numbers of each cable (total of 140 numbers equivalent to 1400 metres) instead of the actual requirement of 07 numbers for each cable. This resulted in placement of order for excess quantity of 63 numbers for each cable (total 126 numbers equivalent to 1260 metres).

Further, it was seen (August 2014) that against a total quantity of 1400 metres of cable to be received by MO (V) as per the PO placed by it, the firm supplied (March 2014) only 140 metres of cable to MO (V). However, payment was made by MO (V) for a total quantity of 1400 metres of cable, resulting in excess payment of ₹1.03 crore to the firm, in spite of short receipt of 1260 metres of cable.

In reply to the audit observation (August 2014) regarding excess payment and short receipt of cables, MO (V) stated (September 2014) that the indent of 70 numbers cable was raised based on HQENC directives (September 2012) and the denomination in Integrated Logistics Management System (ILMS) for this cable was in numbers. Hence, the indent and PO was issued for 70 numbers cable. MO (V) also stated that the firm had not informed them that one number had been mentioned as 10 metres in GRSE

PO as compared to one number equalled to one meter in the MO (V) PO (December 2013).

The reply of MO (V) is not acceptable because the approved list by IHQ MoD (N) contained denomination of cables in metres only. Despite being the consignee for the PO (December 2012) placed by GRSE on the firm, MO (V) failed to analyse the PO in which the denomination of one number of cable was given as equal to 10 metres.

The firm admitted (November 2014) to MO (V) that the balance quantity of 1260 metres cables had remained with them erroneously and the same had been supplied (November 2014) subsequently to MO(V). MO (V) requested (November 2014) the firm to roll back the excess quantity supplied and also return the excess payment incurred on additional cables. In response, the firm accepted (December 2014) that the quantity of cable ordered was more than the actual requirement, however stated that being PSU, they were not in a position to take back the material once sold out.

MO (V) requested (December 2014 and January 2015) to the firm for intimating the exact quantity of cables that can be utilised against a contract concluded (February 2014) by IHQ MoD (N) for procurement of 27 Echo Sounders (Ver 3.1). The firm replied (February 2015) that if IHQ MoD (N) agreed to delete the items from the B&D spares list of the contract, supplied items could be adjusted against this supply order internally. Accordingly, MO (V) requested (March 2015) IHQ MoD (N) that the IHQ contract be amended to incorporate availability of the two cables. IHQ MoD (N) refused (May 2015) to amend the contract quantity in the contract, reasons for which were not available in the records of MO (V).

Thus, lack of due diligence on the part of MO (V) in evaluating the specifications while placing the purchase order led to excess procurement of cables and resultant avoidable expenditure of ₹1.03 crore.

3.6 Non-exercise of Tolerance Clause resulting in avoidable extra expenditure of ₹1.44 crore

Lack of due diligence by Navy in consolidating the requirement before issuing of Request for Proposal (RFP) led to issue of two separate RFPs for same type of equipment within eight months. Further, it did not invoke the provision of Tolerance Clause included in the RFP which resulted in procurement of the same item from the same firm at a much higher rate thus incurring an extra expenditure of ₹1.44 crore.

The Defence Procurement Manual (DPM) stipulates that the Service Headquarters must put in place a system for data sharing and data networking to obviate different prices being paid for the same item. Further, as per the Tolerance Clause included in the Request for Proposal (RFP) the buyer has the right to increase or decrease the quantity of required goods up to 50 *per cent* without any change in the terms and conditions and price quoted by the seller, before conclusion of the contract.

We noticed (March 2014) that Integrated Headquarters Ministry of Defence (Navy) {IHQ MoD (N)} issued an RFP (January 2010) for procurement of three Radio and Blinking Equipment and the contract was concluded (November 2010) with M/s Spets Techno Exports Ukraine (M/s STE) at a total cost of USD 334,676.09 (₹1.53 crore) for three equipment (Unit price USD 111,558.7 i.e. ₹0.51 crore[15]). We further noticed (March 2014) that before conclusion of the contract, IHQ MoD (N) issued (August 2010) another RFP for two more Radio and Blinking equipment. The contract was concluded (August 2011) with the same firm i.e. M/s. STE at USD 550,779.88 (₹2.46 crore) (Unit price USD 275,389.94 i.e. ₹1.23 crore[16]).

We observed (March 2014) that Navy initiated two separate procurement processes by issuing RFPs for three and two numbers of the same type of

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[15] @ 1USD= ₹45.60
[16] @ 1USD = ₹44.70

equipment within eight months (January 2010 and August 2010) which clearly indicates that the calculation of required quantities by Navy was not done prudently. Further, instead of invoking the Tolerance Clause of RFP issued in January 2010, IHQ MoD (N) issued fresh RFP in August 2010 leading to conclusion of a contract (August 2011) which was 142 *per cent* higher than the first contract (November 2010).

On this being pointed out (January 2015), Ministry stated (May 2015) that efforts were made to bring down the item-wise rates but was not accepted by the firm. It was also stated by the Ministry that the procurement quantity (PQ) vis-à-vis RFP (January 2010) was proposed to be increased from three to seven which was not accepted by the firm, as the rate quoted by the firm, M/s STE in this case, was a special rate. The indent was approved for three numbers and hence, the Tolerance Clause was not applied to the contract.

This justification is not acceptable as the bid of M/s STE did not mention the price offered by the firm as a special price and its non-acceptance of the Tolerance Clause included in the RFP. Thus, the firm was bound to accept the additional quantities as per the RFP since the procurement process against RFP (August 2010) was still continuing.

Thus, Navy did not apply due diligence in consolidating the requirement before issuing the RFP in January 2010, leading to issuance of two separate RFPs. Further, it did not invoke the provision of Tolerance Clause included in the RFP which resulted in procurement of the same item from the same firm at a much higher rate, thus incurring an extra expenditure of ₹1.44 crore[17].

[17] (₹1,23,09,930 - ₹50,87,077) X 2 = ₹1.44 crore

3.7 Avoidable payment of interest amounting to ₹1.15 crore

Undue delay by the Engineer-in-Chief Branch in taking up an Arbitration Award, for seeking advice of the Legal Advisor (Defence) resulted in an avoidable payment of penal interest of ₹1.15 crore. Moreover, a Project sanctioned in 2003 is still languishing even after a lapse of 12 years with a 42 *per cent* increase in Project cost.

The Military Engineer Services (MES) Manual on Contracts (2007) stipulates that after publication of an Arbitration Award where decision of Legal Advisor (Defence) [LA (Def)] is warranted, the case shall be analysed with reference to the award in the Engineer-in-Chief's Branch (E-in-C's branch) and then be sent to the LA (Def) through MoD seeking advice, whether to contest or accept the Arbitration Award. It is further laid down that such cases in E-in-C's Branch should be processed within 10 days of receipt of case in the E-in C's branch.

Ministry of Defence (MoD) sanctioned (February 2003) ₹63.47 crore for "Provision of Officers Married Accommodation at Indian Naval Academy, Ezhimala". The Chief Engineer Naval Academy (CE) (NAVAC) Kochi concluded (March 2003) a contract with M/s Engineering Projects (India) Ltd., Chennai (M/s EPI), a Public Sector Undertaking (PSU), for execution of the work at a cost of ₹58.77 crore. The contract was based on a Fast Track Procedure for Naval Academy Project, which stipulated that there would be no escalation clause in these contracts. The work was to be completed by December 2004.

The work commenced in March 2003 but could not be completed on time for reasons beyond the control of the contractor, who sought (December 2004) an extension of time till 31 December 2005. The CE granted (January 2005) the extension up to December 2005 without any financial implications. However, due to slow progress of work , the CE cancelled (May 2005) the contract at the risk and cost of M/s EPI and concluded (November 2005) a risk and cost contract with M/s Iragavarapu Venkata Reddy Construction Infrastructures & Projects Ltd., Hyderabad (M/s IVRCL) at a cost of ₹62.76 crore for completion of incomplete works by April 2007.

Meanwhile, in May 2005, M/s EPI invoked the Arbitration Clause claiming ₹45.35 crore from Military Engineer Services (MES). The arbitrator, appointed in February 2009, pronounced (November 2011) an award of ₹9.21 crore plus interest at 15 *per cent per annum* (p.a) in favour of M/s EPI. This award was not accepted by both the parties and the matter was taken up (December 2011) with the Appellate Authority who finally passed (April 2012) an award of ₹8.96 crore plus interest at 12 *per cent per annum* (i.e ₹16.31 crore) from June 2005 till April 2012, in favour of M/s EPI. The award also stipulated that if the entire award amount including interest was not settled within two months from the date of issue of order, then MES would be liable to pay additional interest @ 3 *per cent* p.a. from the date of the order till the date of realisation.

CE Kochi sought (May 2012) advice from the Directorate of Contract Management, Engineer-in-Chief (E-in-C) Branch, New Delhi for further course of action against the award of April 2012. Audit observed (June 2013) that the E-in-C branch took up the matter with Legal Adviser (Defence) (LA (Def)) in January 2013 i.e. after a delay of nine months from the date of the award (April 2012). The LA (Def) advised (February 2013) the E- in-C that the award of April 2012 was to be implemented as the award of the Appellate Authority was binding upon the parties finally and conclusively. In March 2013, MES compensated M/s EPI with an amount of ₹17.27 crore which included ₹1.15 crore[18] in excess of the Award of ₹16.12 crore[19], by way of additional (penal) interest, which was avoidable.

While accepting the facts and figures, Engineering-in-Chief's (E-in-C) Branch stated (June 2014) that the delay occurred due to non existence of clear and proper procedure for dealing with such cases at various Government levels. This contention of E-in-C Branch is not acceptable since in violation of the

[18] Amount paid ₹17.27 crore (-) Amount of award ₹16.12 crore = ₹1.15 crore (interest @12% p.a. from June 2005 to April 2012)

[19] Award passed in favour of EPI = ₹8.96 crore + 12% p.a. from June 2005 to April 2012 = ₹16.31 cr
Amt in favour of MES to be claimed from EPI = ₹11 lakh + 12% p.a. from June 2005 to April 2012 = <u>₹0.19 cr</u>
Thus Net award passed in favour of EPI = <u>₹16.12 cr</u>

laid down timeline (i.e 10 days), the E-in-C Branch took up the matter with LA (Def) only in January 2013 i.e after a delay of nine months from the date of award (April 2012).

Further, the existing contract with M/s IVRCL had also been cancelled with effect from July 2014 due to financial problems faced by the contractor and a risk and cost contract had been concluded in March 2015. The physical progress of the work (June 2015) was 0.30 *per cent.*

Thus, in violation of the prescribed timeline under the Arbitration Award, inordinate delay in taking up the matter with appropriate authority for payment to the contractor resulted in an avoidable payment of ₹1.15 crore by way of additional (penal) interest. Further, the work on the married accommodation undertaken (2003) at a cost of ₹58.77 crore by invoking the Fast Track Procedure, remained incomplete even after a lapse of 12 years and an expenditure of ₹83.78 crore (26 June 2015).

The matter had been referred to the Ministry (January 2015); their reply was awaited (August 2015).

3.8 Unwarranted procurement of Electric Tachometers

Material Organisation, Mumbai{MO (MB)} concluded a contract in May 2009 for purchase of 14 Tachometers at a cost which was about 15 times higher than the Last Purchase Price of another contract concluded just two months before, in March 2009, for purchase of 24 Tachometers resulting in extra expenditure of ₹76.44 lakh. Further, in gross violation of Defence Procurement Manual, MO (MB) raised the indents for procurement of Tachometers without assessing the requirement which led to 23 Tachometers worth ₹85.74 lakh lying in stock for the last four years without any demand.

The Defence Procurement Manual 2006 (DPM-2006) stipulates *inter alia*, that every authority delegated with the financial powers of procuring goods in public interest should take care to avoid purchasing quantities in excess of requirement to avoid inventory carrying costs. In addition, reasonableness of prices must be based on a careful analysis of the prices offered and after establishing the price reasonableness in relation to the estimated rates, Last Purchase Price. Further, the relevant Naval Instructions stipulates that with the introduction of Integrated Logistics Management System (ILMS) the review process of the entire Naval Inventory is to be carried out on an annual basis as per centrally approved and promulgated Annual Review Plan.

Material Organisation, Mumbai {MO (MB)} raised an indent (May 2007) for procurement of 12 Tachometers[20] for 6K/12K[21] routine on Gas Turbine Generators (GTGs) for Delhi class of Ships[22]. Within seven months of this indent, MO (MB) raised three more indents in December 2007, for 14 Tachometers (6Nos+2Nos+6Nos) to cater for urgent requirement of 6 K routines of all three Delhi Class Ships. Thereafter, MO (MB) reviewed (February 2008) the indent of May 2007 and the requirement was increased from 12 Tachometers to 24 Tachometers. This increase was approved by the Naval Logistics Committee (NLC) without taking into account pending three indents for 14 Tachometers. Against the indent of May 2007, tenders were floated (August 2007) by the Directorate of Procurement (DPRO) to 11 firms of which two firms responded and M/s Tekhkom International Co., Ukraine (M/s Tekhkom) emerged as the L1 firm.

When this procurement process was underway, IHQ MoD (Navy) issued (February 2008) Propriety Article Certificate (PAC) status to FSUE Rosoboronexport, Moscow, Russia (M/s ROE) for GTGs and its spares. PAC status was granted to M/s ROE being the sole authorized agency designated to deal with the OEM and also to ensure availability of spares. Subsequently, against the three indents of December 2007 for 14 Tachometers, tenders were floated (August 2008) by DPRO IHQ MoD (Navy) to M/s ROE on PAC basis.

In the meantime, contract (March 2009) against indent of May 2007 was concluded by the DPRO, IHQ MoD (Navy) with M/s Tekhkom for 24 Tachometers at a cost of USD 22800[23] (i.e ₹9.70 lakh) {unit price $950 i.e. ₹0.40 lakh}. These items were received between November 2009 and June 2010.

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20 A Tachometer (revolution counter) is an instrument measuring the rotation speed of a shaft or disk as in a motor or other machine. The devices usually display the RPM (Revolution per Minute) on a calibrated analogue dial.

21 6K/12K routine means 6000 hourly and 12000 hourly routine on Gas Turbine Generators (GTGs)

22 Delhi Class Ships- 3 ships-INS Delhi, INS Mumbai, INS Mysore

23 $ 22800 for 24 Tachometers. Hence Unit price $950 i.e. ₹40423{@ 1USD= ₹42.55}

As against the three indents of December 2007 for 14 Tachometers, contract was concluded by DPRO (May 2009) with M/s ROE at a total cost of USD 166,693[24] (i.e. ₹82.04 lakh) {unit price $11907 i.e. ₹5.86 lakh}. These items were received between September 2010 and October 2010.

We observed (April 2014) that Navy, while concluding the contract with M/s ROE for procurement of 14 Tachometers in May 2009, was aware of the Last Purchase Price (LPP) for the items procured under the contract concluded in March 2009 with M/s Tekhkom. However, Navy procured the items at a much higher rate which was 1153 *per cent*[25]more than the LPP resulting in extra expenditure of ₹76.44 lakh[26]. We further observed that out of the total 38 Tachometers received, only 15 tachometers were issued to the ships since January 2010 with the last issue being in October 2012. The ad-hoc nature of procurement resulted in the balance 23 Tachometers worth ₹85.74 lakh[27] lying in stock which indicates improper assessment of the requirement.

On this being pointed out by Audit (April 2014), IHQ MoD (Navy) admitted (May 2015) that the three indents of December 2007 might not have been cancelled due to lack of knowledge of the indenting/ procurement officer regarding the total fitted quantity on Delhi Class Ships. This response of IHQ MoD (Navy) is an attempt to cover up the negligence of MO (MB) for gross violation of the DPM norms which stipulates *inter alia*, that every authority delegated with the financial powers of procuring goods in public interest should take care to avoid purchasing quantities in excess of requirement to avoid inventory carrying costs. IHQ's response also confirms the audit contention that MO (MB) did not assess the requirement correctly as the indents for procurement of 14 Tachometers were raised without considering the earlier indent of May 2007 though this was reflected in the Integrated

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[24] $ 71439.78 + $ 23813.26 + $ 71439.78 = $ 166692.82 i.e. $ 166693 (for 14 Tachometers)
Hence Unit rate $ 11907 i.e. ₹ 5.86 lakh {@1 USD= ₹ 49.25}

[25] $ 11907 (May 09) - $950 (March 09) / 950 * 100 = 1153*per cent* escalation

[26] ₹5.86 lakh (Unit price of June 2009) - ₹0.40 lakh(Unit price of March 2009) * 14 Tachometers = ₹76.44 lakh

[27] Data from the Electronic Bin Card that shows the receipt/issue details:-
14 Nos. worth ₹. 82.10 lakh (unit rate ₹. 5.86 lakh)
9 Nos. worth ₹ 3.64 lakh (unit rate ₹. 40423)
₹ 85.74 lakh

Logistics Management System (ILMS). Further, the reply of IHQ was silent on the issue of higher cost.

IHQ further stated (May 2015) that the present stock would be utilised by these ships in future considering the residual life of Delhi class and newly commissioned Kolkata class of ships. The reply is not acceptable as the forecast details at MO (MB) in the ILMS revealed (April 2015) that only a small quantity of four Tachometers had been slated for issue between 2016 and 2019. Moreover, the Kolkata Class ships were still under construction and the likelihood of using it in the near future was remote, as only one of the three ships had been commissioned (August 2014).

Thus, procurement of Tachometers on PAC basis though the same were available from other sources led to an extra expenditure of ₹76.44 lakh. Further, incorrect assessment of requirement of these items in violation of DPM norms led to tachometers worth ₹85.74 lakh lying in stock (July 2015) for four years without demand.

The matter was referred to Ministry (January 2015); their reply was awaited (August 2015).