CHAPTER V: MINISTRY OF STEEL

Hindustan Steelworks Construction Limited

5.1 Execution of Jobs

5.1.1 Introduction

Hindustan Steelworks Construction Limited (HSCL or the company) is under the administrative control of Ministry of Steel, Government of India. The main objectives of the company include execution of construction projects for iron and steel works and ancillary plants. HSCL provides Project Management Consultancy (PMC) to projects as well as undertakes direct execution of projects across wide range of infrastructure sectors like roads, steel, power, mining, railways and other sectors like education and health. It operates through its headquarters based in Kolkata and 34 site offices spread all over the country.

5.1.2 Audit Objective, Scope and Methodology

Audit reviewed the execution of jobs by the company to assess whether (i) execution of projects was efficient and expeditious; (ii) monitoring was adequate and effective at all levels and (iii) the award of work contracts to sub-contractors was transparent, competitive and fair.

This thematic study covered a period of three years from 2012-13 to 2014-15. During this period HSCL secured 1,398 contracts valuing ₹ 5,653 crore. Out of 34 units of the company, audit selected 10 units based on their turnover. These units secured 1299 contracts valuing ₹ 4,226.68 crore during this period. Of these 1299 contracts, audit selected 188 contracts (all the 64 contracts valuing more than ₹ 10 crore; and 124 contracts from remaining 1,235 contracts) valuing ₹ 3,968.96 crore which covered 70 *per cent* of company's total contract value. Audit examined the records of the selected contracts, work manual, other operating procedures and minutes of the meetings of the Board of Directors. This report was finalized after considering the management replies dated 8 January 2016.

5.1.3 Audit findings

5.1.3.1 Deficiencies in Works Manual

The guidelines contained in Works Manual - 2004 were not sufficient to address the changes in business model of the company which shifted from departmental execution to execution by sub-contractors on a back to back basis. Audit noted that the Works Manual of 2004 was updated and approved (June 2010) by the Board but the same was not implemented. Management stated that analysis of provisions of 2010 manual revealed that they were not capable of implementation because of constraints of existing organizational structure, embargo on induction of additional manpower and changed nature of business of HSCL. Due to recommendations of Board for Reconstruction of public sector enterprises (2008) on financial, business and organastional restructuring of HSCL, it was not felt practical to implement the 2010 manual. Reply is to be reviewed in light of the fact that the company did subsequently introduce a new Standard and Commercial Operating Procedure (SCOP) – 2015, five years later in September 2015, although its restructuring proposal is yet to be approved by the Government of India (GOI).

5.1.3.2 Absence of timeframe for different stages of awarding a contract and delays in award of contracts

Works Manual-2004 did not contain any timeframe for tendering and awarding the contract for offloading the work to the sub-contractors, after securing the orders from the clients. In the absence of a defined timeframe for awarding the work, audit had considered the timeframe stipulated in SCOP - 2015 for award of work to the sub-contractors, according to which contracts under open tender were to be awarded within four weeks, and those under limited tender within three weeks, from the date of securing the contracts from the client. Based on this time frame, there were delays in 147 contracts out of 188 contracts as shown in the Table 1 below.

Table 1: Analysis of delay in award of contracts

Range of values of contracts audited	No. of contracts audited	Cases where delay in award of contract was observed			
		Total no. of cases	Delay of 3-6 months	Delay of 6-12 month	Delay of Over one year
More than ₹10 crore	64	43	5	14	14
Less than ₹10 crore	124	104	31	10	11
Total	**188**	**147**	**36**	**24**	**25**

Management attributed the delays to the submission by the clients of only tentative scope at the time of award and late submission by clients of approval of concept plan, preliminary estimates, drawings, and bills of quantity (BOQ). Reply is not acceptable because out of 188 contracts audited, there was delay of over three months in 85 contracts including delay of over one year in 25 contracts. Moreover, issues cited for delay were expected to be firmed up prior to award of contracts.

5.1.3.3 Open mode of tendering not followed

Approved Rate Structure (ARS) gives the breakup of 'per unit construction cost' based on standard rates like DSR[1], schedule of rates of states, past experience and market rates for different types of works. Vendors were empanelled under specialized categories based on their bid capacity to work on ARS. Audit observed that the process of award of work on ARS was not competitive because in majority of cases the work was entrusted on nomitation basis. Review of 181 offloaded contracts revealed that open tender route to award the contract to vendors was adopted only in 45 cases (25 *per cent*). 22 contracts (12 *per cent*) including 8 contracts of ₹ 10 crore or more were awarded on the basis of limited tender enquiry (LTE) and 112 contracts (62 *per cent*) including 10 contracts of ₹ 10 crore or more were directly awarded to empanelled contractors on ARS. Audit also noted that vendor database was not updated through open advertisement during last three years (2012-2015) to weed out the non-performers and to include the fresh entrants in the field.

[1] ***Delhi Schedule of Rates***

Management stated that award of work on ARS did not fall under 'nomination basis' and it was the practical strategy when the client expressed urgency in the start of work. It had higher margin retention than open/ limited tenders. The reply is to be seen in the light of the fact that split-up of work (similar nature jobs and others) compromised with general financial controls like delegation of power, adoption of open tender route for competitive rates, financial assessment of contractors' capability etc. Absence of any specific criteria for selection of contractor while awarding work on ARS provided scope for adhoc selection of contractors.

5.1.3.4 Splitting of contracted work for award of sub-contracts

As per Delegation of Power framed by the company in 1999, Executive Director, Group General Manager and General Manager of the company were empowered to award the work on ARS basis up to ₹ 75 lakh, ₹ 25 lakh and ₹ 10 lakh respectively. Audit observed that 14 contracts awarded to the company valuing ₹ 133.59 crore audit observed were split into 160 contracts and offloaded amongst 32 different contractors mostly on LTE or ARS basis, and similar nature work was sub-contracted through a number of work orders as given in Table-2 (a) and (b).

Table 2: Statement showing spliting of contracts into multiple sub-contracts

(a)	**Details of 14 contracts split into 160 sub-contracts**						
HSCL offices	**Work Order No.**	**Nature of Works**	**Value (₹ in crore)**	**Split (No.)**	**Sub-contractors (No.)$**	**OTE/LTE/ARS**	**Days taken#**
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Bokaro	4565011703	Slag disposal SMS-I	7.41	10	1	ARS	376-500
	4565011704	Slag disposal SMS- II	13.09	30	4	ARS	383-500
	4565014656	Hiring loco operators	1.89	8	4	ARS	56-522
	4565015250	Shunting operation	3.18	18	5	ARS	45-378
	4565016781	Deployment of PRW	0.41	4	4	ARS	89-112
	5465015095	Hiring of PRW	0.16	4	3	ARS	74-110
Bhuban-eswar	Proj/3985/12	Civil Construction	37.79	6	4	LTE	88-243
Kolkata	2010NVS(W)	School Construction	16.28	2	1	LTE	599
Delhi	144/09(vol. II)/611	Civil Construction	27.00	3	2	Open 1/LTE 2	456-800
	2014NVS(W)	Civil Construction	21.40	3	1	LTE	92-161
Lucknow	CSR/2013	26 School Classroom	1.98	26	2	ARS	42-110
	CSR/2013/48	10 School Classroom	0.76	10	3	ARS	58-121
	CSR/194	26 School Classroom	1.71	26	3	ARS	71-280
	CSR/194	10 School Classroom	0.53	10	3	ARS	161
(b)	**Similar work sub-contracted through number of work orders**						
Kolkata	*20 March 2013	13 Godowns Construction	43.35	-	6	LTE	169-320
	*March-May 2013		28.18				

 # Days taken to sub-contract the works in days; *date of award from the client West Bengal Govt.

$ There were total 32 sub-contractors who worked in 14 contracts, some of the sub-contractors being repeated in multiple contracts.

Audit analysis of contracts mentioned in table 2 (a) and (b) revealed the following:

- Two work orders (4565011703 and 4565011704) at Bokaro for slag removal from SMS-I and SMS-II[1] valuing ₹ 7.41 and ₹ 13.09 crore respectively, were split into 10 and 30 work orders respectively, and were awarded between one and four parties respectively. Management stated that such jobs are to be continued without interruption even for a day. The reply was not acceptable as the work was received in September 2012 but was subcontracted only between July 2013 and September 2014.
- Work of construction of National Law University (NLU) campus at Bhubaneswar (Proj./3985/12) valuing ₹ 37.79 crore was split up into six contracts limiting the value of each contract below ₹ 10 crore and thereby avoiding the need for open tender. Management did not offer any specific comment on this issue.
- Two contracts at Delhi [2014 NVS (W)] and Kolkata [(2010NVS*(W)]* unit valuing ₹ 21.40 crore and ₹ 16.28 crore respectively, were split into three and two parts respectively and awarded to a single sub-contractor on LTE basis. The management stated that in respect of work of Delhi unit the split of work into three packages was approved by the client and were tendered separately but eventually the same agency became the lowest bidder for all the three packages. In case of contract relating to Kolkata, split of work was resorted to for speedy execution of work. The reply is not acceptable because in Delhi unit the name of a particular contractor was included in all the three separate tenders invited on LTE basis and the same contractor was eventually selected in all three cases. Resultantly, he was awarded the work of ₹ 21.40 crore against his empanelled bid capacity of ₹ 5 to 10 crore only, which indicated undue favour to the contractor. In the case of Kolkata uni*t* abnormal delay of 599 days was noticed in award of work. The work could be completed in January 2015, even though it was scheduled for completion in September 2012.
- The work for construction of 72 classrooms valuing ₹ 4.98 crore at different locations were received by Lucknow unit, out of which construction of 49 classrooms were awarded to a single contractor on ARS basis in spite of client's instruction to award the work through tendering as per procedure and CVC norms. Management stated that there was urgency from clients to speedily implement their CSR projects and work on ARS was considered to avoid delay compared to the process of tendering. Reply is not acceptable as the works in different locations were awarded on ARS to seven empanelled contractors and one of them got 49 contracts in different locations. Therefore, company's argument for splitting the works among large number of contractors for speedy execution does not hold true.
- The West Bengal Government awarded construction of 13 food godowns during March-May 2013 for total value of ₹ 71.53 crore to the company which in turn off-loaded the work among six contractors between August 2013 and February 2014, through 13 separate awards on LTE basis despite provision of a clause 1.8 in MoU with the client which stipulated that e-tendering was to be followed by the company for enhancing the transparency in the entire process. Management stated that EOI invited for initially five godowns remained non responsive, and

[1] ***Steel Melting Shop I and II in Bokaro Integrated Steel Plant of SAIL.***

subsequently LTE was used. The reply is not acceptable as the management did not go for retendering and invitation of one open tender for all the 13 godowns had fair chances of attracting large number of bids.

Audit is of the opinion that splitting of bigger works results in approval of higher value work being granted by subordinate officers and results in these works being executed by contractors with lower bid capacity and it further circumvents the more competitive open tender route. The nature of works in column 3 of Table 2 was not diverse so as to warrant splitting of these works.

5.1.3.5 Lack of adequate publicity in invitation of bids

Audit noted that the tender notices published in newspapers did not contain vital information relating to tenders like estimated value of work, earnest money, place of work and duration of completion of contract. Management replied that to control the cost, all the details were not given in the abridged version of advertisements, and bidders were referred to the Central Public Procurement Portal (CPP) on company's website for further details. Reply is not acceptable because the notifications excluded vital information required for inviting participation from appropriate class of contractors.

5.1.3.6 Lack of adequate due diligence in tender evaluation procedure

The contract for hiring the equipment for Ramnagore Colliery's (a captive mine of SAIL) scientific exploitation work valuing ₹ 47.15 crore was sub-contracted (March 2012) to Asansol based M/s PS Mining and Construction through open tender. Audit scrutiny revealed that there were limitations in the bid documents submitted by the contractors which were ignored by the tender evaluation committee while finalising the award. The contractor did not complete the awarded work and the contract was terminated (March 2013) which indicated that technical evaluation of the contractor was deficient. Management replied that the tender committee was satisfied with bid documents submitted by contractor showing ownership and possession of equipment and selection process was not deficient. Contractor did not submit the bank guarantee despite follow up. Management reply should be seen in the light of the following:

- Invoices showing ownership and possession of equipment by the contractor had tampering marks and were addressed in his name with different addresses (i.e. of Delhi, Haryana, Bihar and Chhattisgarh) than their Asansol address even though the work was to be executed in West Bengal. Two letters from the previous clients for confirmation of business experience were dated prior to the dates of work orders referred therein;

- Despite tender requirements, technical committee accepted a cheque in place of demand draft towards processing fee from the contractor, even though this contractor was disqualified on the same ground, on an earlier occasion. The contractor had to submit the Performance Guarantee of four *per cent* of the contract value within 45 days of Letter of Acceptance (LOA) which he did not submit. This was an undue favour extended to the contractor because HSCL had to deposit full eight *per cent* of Performance Bank Guarantee (PBG) with the client. Hence, the company did not safeguard itself against the risk of non-performance by the contractor;

- An interest bearing advance of ₹ 85 lakh was paid to the contractor in two installments (July-September 2012) in violation of terms of contract on the basis of wrong statement that he had completed the work valuing ₹ 99.49 lakh till June 2012 whereas the actual work executed by him on that date was only to the tune of ₹ 64.83 lakh. An amount of ₹ 3.66 crore still remained recoverable (January 2016) from the contractor on account of interest bearing advance, hire charges and liquidated damages.

5.1.3.7 Delay in submission of Performance Bank Guarantee (PBG)

Audit observed the following with regard to submission of PBG:

(i) There was delay ranging from 10 days to 288 days over permissible time, in submission of PBG by the contractor in 35 contracts valuing ₹ 241.46 crore.

(ii) In respect of two contracts namely, construction of Ash Pond inside Bellary Thermal Power Station (BTPS) and Para-Medical Institute in Gulbarga at Karnataka the terms of contract stipulated that HSCL should submit PBG at 10 *per cent* and 5 *per cent* respectively to its client and the same was to be obtained from the contractors as Counter Bank Guarantee (BG). As per the policy of the company, expenditure incurred by HSCL on BG commission was to be recovered from the contractor. Audit observed that on the request of contractor in case of BTPS work, HSCL allowed the contractors to deposit the PBGs directly with the clients (in both the cases) to save the commission on BG given by HSCL and recoverable from the contractors. Thus, the company favoured the contractors and did not hold BG of ₹ 25.74 crore[1] from the two contractors to mitigate the risk of breach of contract by them.

(iii) In contracts for scientific exploitation of coal in Ramnagore Colliery, the company failed to ensure deposit of PBG ₹ 3.77 crore, and ultimately, the contractor failed to perform. In case of 'Reconstruction of roads in township of Durgapur Steel Plant', the company failed to recover Security Deposit ₹ 32.83 lakhs through RA Bills from the contractors as he abandoned the job without submitting any bills. Resultantly, additional cost of ₹ 1.99 crore incurred on retendering of work could not be compensated to the extent of SD amount.

Management stated that (i) delay in submission of PBG and/or recovery from running bills was considered with the approval of competent authority with valid reason to avoid cancellation of contracts. (ii) there was no financial risk involved to HSCL by submittin PBG directly to the client, (iii) contractor did not submit bank guarantee despite repeated communication and abandoned the job without submitting bills. Reply is not acceptable in the light of the fact that (a) not ensuring timely deposit of PBG had risks as PBG condition is included in tender/contract to safeguard against the non-performing

[1] BG amount ₹ 11.92 crore (10% of contract value ₹ 119.23 crore) in case of Bellary Thermal Power Station and ₹ 13.82 crore (5% of contract value ₹ 276.47 crore) in case of Para Medical Institutes

contractors. (b) deposit of PBG by the sub-contractors directly with the client would not mitigate the risks to company against non-performance of the contractor. (c) due to non-adherence with the terms of PBG the loss suffered by company could not be compensated to the extent of BG amount.

5.1.3.8 Execution of contract

(I) Failure to take action under 'Risk and Cost' clause

Every contract awarded by the company included a 'risk and cost' clause. Audit noted that the company failed to initiate action under the 'risk and cost' clause against six contractors when they failed to execute the contractual liabilities, and as a result, such work had to be carried out at total additional cost of ₹ 20.40 crore to the company as given in the Table 3.

Table 3: Details of risk purchase action not taken and/or not pursued

(₹ in crore)

Work	Name of Contractor	Status of work	Amount to be recovered under Risk and Cost clause	Adjusted	Amount Unrealised
Civil works of URM[1] in BSP/SAIL	Amar Infrastructure and Jaya Projects	Work abandoned by contractors in 10/2012 and 09/2014. Contract not terminated	12.76	3.32	9.44
Reconstruction of roads DSP/SAIL	R. P. Construction	Work abandoned by contractors in 2012. Contract not terminated	1.99	-	1.99
Workshop Const. CLW[2]	Happy Hi-Rise Infra Ventures (P) Ltd	Contract terminated in 07/2012	1.05	0.40	0.65
PMGSY	Dilip K Kar and Kalyani Debnath	Contracts terminated in 12/2013 and 09/2014	11.73	3.41	8.32
Total			**27.53**	**7.13**	**20.40**

Management stated that efforts were being made to recover the amount including any dues payable to them in other contracts. An amount of ₹ 20.40 crore remained to be recovered from contractors (till January 2016) despite lapse of considerable time from abandonment of work by them/ termination of contracts.

(II) Irregular payment of ₹6.83 crore to the contractor

The company was nominated by Government of Tripura as Programme Implementing Unit (PIU) for construction of rural roads under Prime Minister Gram Sadak Yojana (PMGSY). The company off-loaded a part of work to M/s Dilip Kumar Kar under three Notice Inviting Tender (NIT) for a total value of ₹ 56.36 crore. The contractor abandoned the job before its completion. Audit noted that though the contractor executed the work for only ₹ 33.45 crore, the site office paid ₹ 40.28 crore to the contractor including payment for some incomplete work abruptly suspended by the defaulting contractor. No

[1] ***Universal Rail Mill***
[2] ***Chittaranjan Locomotive Works***

investigation was carried out to find out the reasons for excess payment of ₹ 6.83 crore. Management stated (November 2015) that the matter had already been intimated to the defaulting contractor and the case is sub-judice. Reply of the management is not acceptable as the fact remains that incomplete and abruptly suspended work was also measured while making payment to the contractor.

(III) Non safeguarding of company's interest due to deficiencies in agreement.

(a) The company was appointed PIU for PMGSY projects in Jharkhand. Ranchi unit of the company incurred ₹ 48.96 lakh on preparation of DPRs (during 2012-15) for 59 roads/bridges construction packages which were subsequently cancelled by the Jharkhand State Rural Road Development Authority (JSRRDA). The company did not raise any claim on JSRRDA for reimbursement. *Management stated that they would lodge the claim on JSRRDA for reimbursement and in case of non-admittance; the same will be treated as the business expenditure.* Reply is not acceptable as the company should have envisaged such situation and included reimbursement of cost in the PMC agreement.

(b) The Company secured construction work of 41 new ITIs and 6 polytechnics from Government of West Bengal for a value of ₹ 408.28 crore[1] at five *per cent* Project Management Consultancy (PMC) fees on estimated cost. The modality for payment of agency fee @ five *per cent* was neither defined in the agreement nor mentioned in sanction letter from the client. In absence of defined modalities for payment, as confirmed by the management, the company could not realize the PMC fee of ₹ 14.59 crore[2]. Management stated that the PMC fees of ₹ 14.59 crore[3] was recoverable because five per cent centage charges was yet to be approved by the state government and the bills are under active consideration for payment. The management reply is not acceptable because it was company's responsibility to take up the matter with the client for release the PMC charges. Moreover, the modalities for payment were required to be defined in the agreement.

(c) In respect of construction work for ESIC's Hospital and Para-Medical Institute at Gulbarga Karnataka, contract agreement stipulated centage charges[4] as five *per cent* of work executed to be paid by the client to HSCL in both the works. There was no specific clause to determine the centage charges in case of escalation of project cost. The project cost was escalated in both the cases. As the provision for levying centage charges on escalation cost were not defined in the contract agreement, the client did not release ₹ 6.71 crore in case of Hospital and ₹ 55 lakh in case of Institute for centage charges applicable to the escalated value. *Management stated that matter has been taken up with client.* Management reply is not acceptable because escalation being a normal phenomenon in construction contracts, the company should have provided an appropriate clause in the agreement for revision of centage charges on the escalated cost.

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[1] ***Contracts for 24 ITIs valuing ₹ 185.37 crore, 17 ITIs valuing ₹ 124.21 crore and six polytechnics valuing ₹98.70 crore were awarded in August 2012, July 2014 and July 2014 respectively.***

[2] ***₹14.59 crores is 5 per cent on work executed till March 2015 i.e. ₹291.78 crore.***

[3] ***₹9.62 crore w.r.t. 24 ITIs and ₹4.97 crore w.r.t. six Polytechnics***

[4] ***Centage charges are supervision charges relating to construction works***

5.1.3.9 Non-imposition of Liquidated Damages (LDs)

(I) Clause 44 of PMGSY Standard Bidding Document read with clause 9.10 of Operation Manual provided imposition of Liquidated Damages (LDs) on contractor for delay in completion of works. Though the company was responsible as PMC for deduction of LDs for delays, if any, not exceeding 10 *per cent,* on the part of the contractors, it did not have any incentive for recovering LDs, as the amount of LD was to be adjusted against the project cost borne by the client.

Audit noted that the company did not analyse delays to identify the stages of delay, reasons for delay, and whether delays could be attributed to the contractors. As a result, till September 2015, LDs could not be imposed in 13 cases of delay out of 53 cases of PMGSY works in Tripura. This deprived the implementing government departments of the compensation due to them in the form of liquidated damages from defaulting contractors. A review of 221 out of 393 PMGSY works at Ranchi revealed delays ranging from 40 to 1335 days. *Management stated that all delays could not be attributed to contractors and that Jharkhand government granted extension of time without LDs.* Reply is not acceptable because the company as the PIU, was responsible for determining the extent of delays attributed to the contractor. Non- recognition of LDs means extending undue benefit to the contractor at the cost of the implementing government department.

(II) Lucknow unit of the company did not impose LDs against the contractor for work of 'Construction of Residential Flats' awarded (November 2010) by Small Industries Development Bank of India (SIDBI) for ₹ 6.61 crore on PMC basis, despite 18 months delay in completion caused by contractor's inability to mobilise the resources and persistent reminder from SIDBI to impose LD on the contractor. As per the terms with client, LD at the rate of 0.5 *per cent* for every week not exceeding 10 *per cent* of the estimated cost of the work was to be recovered in case of delay. Management stated that the issue of imposition of LD remains unresolved; SIDBI may bring down the LD up to five per cent; and sufficient amount was under hold against the bills of the contractor to realize the LD amount as soon as the related dispute is resolved. The reply is not acceptable because audit observed that SIDBI had already recovered (May 2015) LD amount of ₹ 66 lakh out of total amount payable to the company but the company had not yet determined the amount of LD to be recovered from the contractor for the delay attributable to him.

5.1.3.10 Non-reimbursement of taxes from client

The terms of contract for construction work for ESIC Hospital and Para-Medical College at Gulbarga, Karnataka (awarded in May 2010 and July 2011 respectively) provided that works contract tax (WCT) and turnover tax paid by the company would be reimbursed by the client on submission of the requisite documents including evidence of payments. The company did not get reimbursement of WCT of ₹ 7.28 crore and turnover tax of ₹ 2.47 crore from the client as it could not furnish all the documents to the satisfaction of the client. Management stated that they were actively pursuing the matter with the client.

Conclusion

The Works Manual 2004 did not lay down timelines for finalisation of tenders, criteria for selection of the mode of tendering, publication of key information in abridged version of Notice Inviting Tenders etc. which contributed to delays in award and completion of work. High value contracts were split into smaller value contracts thereby preventing participation of contractors with better resources. The requirement for submission of Performance Bank Guarantee was not followed in 35 cases. Due diligence was not exercised in selection of contractors. The company could not realize ₹ 21.85 crore as centage charges/PMC fees from the client due to deficiencies in the agreement. On account of Works Contract Tax and Turnover tax ₹ 9.75 crore was not reimbursed by the client, as HSCL could not furnish required documents to their satisfaction. In addition, cases of excess payment of ₹ 6.83 crore to a contractor who left the work incomplete and non-imposition of risk and cost action amounting to ₹ 20.40 crore were also noticed during the audit.

Recommendation

- ***The company may revisit the existing policies, procedures and practices with respect to award and execution of contracts and adequately strengthen the existing internal control mechanism to mitigate the business risks and challenges.***

The matter was reported to the Ministry (January 2016); their reply was awaited (March 2016).

Steel Authority of India Limited

5.2 Marketing Activities

5.2.1 Introduction

Steel Authority of India Limited (SAIL or company) is a Maharatna company under the administrative control of the Ministry of Steel, Government of India. The Central Marketing Organisation (CMO) of SAIL under the overall supervision of Director (Commercial) is responsible for marketing and selling the steel products of its five integrated steel plants through a network of four regional offices, 37 branch sales offices (BSO), 67 warehouses including 42 hired warehouses, and 27 customer contact offices as on 31 March 2015. CMO also appoints and supervises the work of 16 conversion agents[1], 4 wet leasing agents[1] and 2711 authorised dealers besides monitoring the supplies and realization of trade receivables and making market projections for the preparation of company's annual production plan for steel plants. The marketing and selling of secondary products[2] is done directly by marketing divisions of individual steel plants. Audit carried out a review of marketing activities of SAIL to assess the adequacy and effectiveness of company's marketing network, policies and schemes relating to product

[1] Conversion Agents convert semis (like billets, blooms, slabs etc.) supplied by SAIL as well as other producers into finished products (TMT Bars, Structurals, Wire rods etc.) in their premises, whereas, Wet Leasing Agents do the conversion job by leasing out their entire infrastructure to a single producer for a given period of time

[2] Secondary products mainly include Iron & Steel Scrap, Blast Furnace Slag (BF Slag), Pig Iron, Coal Chemicals & By Products, Waste Products etc.

pricing, customer credit, rebates and commission, transparency in appointments of conversion agents/ wet leasing agents/dealers and effectiveness of marketing and selling activities. This study focused on the operations of CMO and reviewed the records of CMO offices including 19 BSOs (out of 37 BSOs) which together contributed about 60 *per cent* of the company's total sales. Audit covered the transactions of five years from 2009-10 to 2013-14 and the status was updated for the year 2014-15.

5.2.2 Audit Findings

5.2.2.1 Sales Performance

Quantity of saleable steel produced by company, sales value, profit after tax, net sales realisation (NSR)[1] per ton and national consumption and availability of finished steel during the six financial years from 2009-10 to 2014-15 is shown in Table-1.

Table 1: National steel production, availability and consumptions and details of the company's sale

Year	Company's Sales in million ton					Sales	Profit	NSR per ton	National Finished Steel Million ton$		
	Total Sales@	Percentage Pvt.	Percentage Govt/PSU	Closing Stock	Market Share	₹ crores			Produced	Available#	Consumed
2009-10	12.11	81	19	0.86	18.5	43935	6754	31030	60.62	64.75	59.34
2010-11	11.72	80	20	1.10	16.2	47041	4905	33962	68.62	71.65	66.42
2011-12	11.42	84	16	0.93	14.8	50348	3543	37329	75.70	77.97	71.02
2012-13	11.11	82	18	1.22	13.8	49350	2170	36291	81.68	84.24	73.48
2013-14	12.07	84	16	1.10	14.6	51866	2616	35572	87.68	87.14	74.10
2014-15	11.71	84	16	1.44	14.2	50627	2093	35198	91.46	95.18	76.99

@ included sale of secondary items, # after adjusting exports and imports, $ Long, flat and PET Finished steel

Review of production and consumprtion of steel in audit indicated:

(i) There was growth in demand for flat, long and PET (Pipes, Electrical Sheets and Tin plated) steel products during the period of review. Country's steel consumption increased from 59.34 million ton in 2009-10 to 76.99 million ton in 2014-15. The company's market share to total saleable finished steel which was 25 *per cent* in 2005-06 however decreased to 18.5 *per cent* in 2009-10 and to 14.2 *per cent* in 2014-15. Company's market share decreased in all three categories of steel products.

(ii) Three special steel plants of SAIL viz. Alloy Steels Plant (ASP) at Durgapur, Visvesvaraya Iron and Steel Plant (VISP) at Bhadravati and Salem Steel Plant (SSP) at Salem were producing significantly below their capacity, and they suffered operational losses regularly (***Annexure-XXI***) because plants were not operated at full capacity due to inability of the company to find market for their products.

Management stated that dip in market share was due to capacity constraint and SAIL sold what it produced and that the overall market share would increase after completion of capacity expansion projects. Management reply should be seen in the light of the fact that

[1] ***Net Sales Realisation = total revenue earned from selling a product - cost of sales return, allowances and discounts***

decrease in the company's market share was largely attributed to the company's failure to complete capacity addition projects commenced in 2006-07 within the scheduled time i.e. year 2010; they are delayed by 4-5 years, whereas the other domestic producers like Tata were successful in capacity additions during the same period, and were able to meet the additional steel demand in the economy.

It may also be seen that even within the existing production, Company's sale of long and PET products was lower than the production, and overall stock in hand increased from 0.93 million (March 2012) to 1.44 million ton (March 2015) (as seen in Table 1). Further, even after price de-control effective from 1992, and subsequent rise in number of competitors, the company has not changed its strategy for pricing, marketing and selling steel products.

5.2.2.2 Sales through Retail Dealership

SAIL has a dealership scheme with the objective of establishing a wide distribution network to promote and popularize SAIL products, and to improve market share and net sale realization in the long-run. The company's dealership network covers 611 districts. The company has been appointing *non-exclusive* Authorized Retail Dealers (ARD) who can sell the products of other steel manufacturers also. The company also launched 'SAIL Rural Dealership Scheme' in the year 2011-12 with the primary objective of meeting the steel demand of the small rural consumers at block, tehsil and taluka levels, but failed to achieve the scheme objectives. Audit observed that out of 910 rural ARDs as of March 2015, only 238 were found to be active. Poor growth in sales in retail sector was attributable to the following.

(a) 975 ARDs constituting 39 *per cent* of total of 2,508 ARDs in 2009-10 and 1,456 ARDs constituting 54 *per cent* of total of 2,711 ARDs in 2014-15 were inactive i.e. they did not lift any material in that financial year. In 261 districts, none of the appointed ARDs were active as on 31 March 2015. Absence of active dealership base had adversely impacted the growth in retail sales. The retail segment contributed only about 5 *per cent* of total sales of the company **(*Annexure-XXII*).**

(b) Company's promotional activities, consisted primarily of masons' meets, engineers, architects' meets and dealers' meet and lately advertisement in FM channels. Annual sales promotion expenditure was meagre, ranging between ₹ 3.72 crore - ₹ 5.45 crore during 2009-2015 which amounted to 0.007 - 0.01 percent of sales turnover in respective years.

(c) Supervision of branch managers was seen to be inadequate. Inactive dealers were not removed as per the terms of their appointment. An examination in audit of randomly selected inactive dealers in Kolkata, Guwahati and Patna districts showed that there was no inspection of ARD's activities by the Branch Offices. In western region, during April 2014 to December 2014, planned visits were 15 to 28 *per cent* of total ARDs and actual visits ranged between 23 to 88 *per cent* of planned visits.

Management admitted (October 2015) that demand in areas where their authorized dealers had become inactive was met by the other main and secondary producers. They also stated that company has been appointing new dealers in the vicinity of the inactive dealers to cater to those areas, the performance of dealers was reviewed on a regular basis and contracts of non-performing ARDs were terminated if performance is not satisfactory. Further the company stated that due to availability constraints of TMT[1] and GP/GC sheets[2], the materials could not be supplied to dealers. Management reply should be viewed in light of the fact that over 50 *per cent* ARDs were always inactive and there was no off-take from them during 2011-2015. The demand of TMT Bars of 8-12 MM sizes which was high at retail networks was not met, because company concentrated on sale of TMT in higher diameter to satisfy the demand of institutional customers though it gave relatively lower sales margin. The company could not enhance the supply of TMT bars because its efforts in last ten years to operationalise 10 departmental Steel Processing Units for conversion of semi-finished goods into TMT bars had so far failed, and five joint ventures formed (2012) with private parties for the same purpose have not been operationalised. The company relied more on high value sales through Memorandum of Understandings (MoUs) with large institutional consumers which accounted for 92 *per cent* of its total sales in 2014-15, and developing customer base in retail sector was accorded lower priority in all these years ***(Annexure-XXIII).***

5.2.2.3 Lack of system to analyse failure in securing contracts

Audit observed that the company participated in 224 tenders during 3 year period from 2012-13 to 2014-15, out of which it was not successful in 69 tenders primarily due to higher prices quoted. The company did not have an effective strategy for seeking business through participation in tenders. The CMO failed to collect the data from the BSOs in respect of tenders participated, won, lost and other related information, and no analysis was being done by the company for losing business in tenders and to formulate future action plan.

5.2.2.4 Sales through Memorandum of Understanding (MoU)

The company largely sold its produce to high end institutional and whole sale buyers through MoUs. Total MoU Sales had increased from 57 *per cent* in 2009-10 to 92 *per cent* in 2014-15 (***Annexure-XXIII***). Rates offered to MoU buyers were driven by granting dispensations consisting of rebates and discounts on lifting of MoU quantities. Audit noted that total dispensation increased from ₹ 2,467 crore (6 *per cent* of sales value) in 2009-10 to ₹ 6,088 crore (13 *per cent*) in 2014-15 in line with the increase in MOU sales. Audit observed that with recent capacity expansion among private steel producers coupled with their cost advantages over the company's product cost, many buyers started adopting open tender route to obtain competitive prices. Audit noted that regular government and PSU customers had been moving from MoU based procurements to open tenders. Central Public Sector Enterprises (CPSEs) like BHEL and NTPC had resorted to open tenders during 2012-2015. The company, however, continued to attract the private customers by dispensing various kind of rebates and discounts within their discretionary power (Paragraph 2.5), and the share of private buyers to the company's total sales quantity rose from 81 *per cent* in 2009-10 to 84 *per cent* in 2014-15 (Refer Table I).

[1] ***Thermo Mechanically Treated (TMT) bars***
[2] ***Galvanised Plain (GP) and Galvanised Corrugated (GC) sheets***

5.2.2.5 Higher prices due to higher costs of production

After de-control of the steel price by the government in January 1992, the prices of its own saleable steel products are being fixed by the company. Since 1997, a Revenue Maximizing Team (RMT) consisting of Plant Heads and 2-3 functional Directors fixes monthly ex-work base price and monthly price adjustment limits (Rebates) that could be dispensed by CMO officials from Director (Commercial) to Heads of BSOs within their discretionary powers. Being a market leader in steel production, SAIL has been setting the price trends in the steel market for other steel producers.
Audit observed that the percentage of cost of raw material consumption to total expenditure and staff cost per ton of steel produced of the company was higher than that of its two competitors. SAIL's cost of raw material to total expenditure was 7-9 and 9-17 percentage points higher than Jindal Steel & Power Limited (JSPL) and Tata Steel Company Limited (TATA) respectively. SAIL's staff benefit expenses in terms of per ton of crude steel produced was ₹ 1,492 and ₹ 2,025 higher than that of RINL (a CPSE) and TATA in 2011-12 and this gap further increased to ₹ 1,631 and ₹ 3,324 in 2013-14.

Table 2: Relative comparison of cost in SAIL with TATA, JSPL and RINL

<table>
<tr><th colspan="6">Particular</th><th>2012-13</th><th colspan="2">2013-14</th><th>2014-15</th></tr>
<tr><td colspan="3" rowspan="3">Percentage of cost of raw materials consumed to total expenditure* (%)</td><td colspan="3">TATA</td><td>34.42</td><td colspan="2">31.46</td><td>34.69</td></tr>
<tr><td colspan="3">JSPL</td><td>42.17</td><td colspan="2">36.01</td><td>36.05</td></tr>
<tr><td colspan="3">SAIL</td><td>51.29</td><td colspan="2">43.41</td><td>43.35</td></tr>
<tr><td colspan="6">Per cent of excess of cost of material in SAIL over TATA-JSPL</td><td>9-17</td><td colspan="2">7-12</td><td>7-9</td></tr>
<tr><td rowspan="3">Staff Benefit Expenses
/ton steel</td><td colspan="3">2011-12</td><td colspan="3">2012-13</td><td colspan="3">2013-14</td></tr>
<tr><td>SAIL</td><td>RINL</td><td>TATA</td><td>SAIL</td><td>RINL</td><td>TATA</td><td>SAIL</td><td>RINL</td><td>TATA</td></tr>
<tr><td>6397</td><td>4905</td><td>4372</td><td>6974</td><td>5066</td><td>4545</td><td>7437</td><td>5806</td><td>4113</td></tr>
</table>

Finance cost and Provision excluded
Source: Annual Reports of respective companies for the period 2011-12 to 2014-15.

5.2.2.6 Rebates and incentives

The Company granted significant amount as dispensations to attract the buyers to buy its product. In five integrated steel plants alone, the company disbursed dispensation of ₹ 26,058 crore in last 6 years and average dispensation per ton increased from ₹ 2241 (7 *per cent* of NSR[1]) in 2009-10 to ₹ 5764 (16 *per cent* of NSR) in 2014-15 (***Annexure-XXIV***).

Audit observed the following:

(a) Impact of multiple level dispensations given to customers on the recovery of product cost were not analysed by management. Even though NSR had increased by 13.43 *per cent* over 5 years whereas the cost of sales[2] increased by 31.16 *per cent*. With the relative cost disadvantage vis-a-vis its competitors coupled with

[1] ***Net Sales Realisation = total revenue earned from selling a product - cost of sales return, allowances and discounts***

[2] ***Cost of sales is the accumulated total of all cost used to create a product/services.***

greater competition from domestic supply and imports, focus of CMO gradually moved from maximisation of revenue to maximisation of the sales quantity by using higher dispensations/rebates adversely affecting NSR in last three years.

(b) Audit scrutiny of 19 BSOs revealed that documentation of dispensations or rebate approval was not satisfactory and the important external factors like competitors' price and import price cited for disbursing higher rebates were not authenticated from the records made available to audit. It was therefore not possible to conclude in audit that rebates etc. granted to various buyers by the CMO officers within their discretionary powers was justified.

(c) The increasing rate of rebate did not lead to increase in the sales volume which decreased from 12,110 thousand ton in 2009-10 to 11,710 thousand ton in 2014-15, and saleable steel inventory of SAIL gradually increased from 26 days to 45 days of its sales volume during 2009-2015.

Management stated that the RMT ensured that the company took a balanced perspective on the prices, keeping in view the markets, production volumes, cost, quality, product mix etc. and to respond in time to market developments in the competitive market. During the period 2009-10 to 2013-14, there were upward revisions of listed based prices, as a result of which the dispensation amount was used to adjust the selling price with respect to the prevailing market price. Over the years company's sales volumes have been taking care of the full production of the steel plants. The fact remains that proper documentation was lacking as it did not contain any evidence in support of justification for extending higher dispensations. Further, the increasing rebates did not result in increase in sales volume.

5.2.2.7 Implementation of order booking policy

Chairman of the company approved order booking policy (OBP) for different segments of customers. As per OBP, MoU is entered into with the customers in the beginning of the year to estimate sales quantity and to accordingly decide production plan. Audit noted the following instances where the CMO did not adhere to the approved OBP:

(a) Undue extension of credit period

OBP applicable for the year 2009-10 to 2011-12 stated that the MoU customers for HR Coils[1] (including special quality) were entitled to 10-30 days Interest free Credit (IFC) which was increased to 10-40 days w.e.f. 2012-13. Accordingly, M/s Tirupati Group, a MoU customer of HR coils was entitled for only 24 days and 15 days IFC for the period of 2009-11 and 2012-14 respectively. There was no provision in MOU for extending IFC up to 60 days. However, after signing the MoUs, on request from customer, the company revised IFC given in MoU to 60 days for the four successive MoUs for the years 2009-10, 2010-11, 2012-13 and 2013-14, thus extending undue benefits of ₹ 3.98 crore. Management stated that (i) a commercial decision was taken to extend IFC to the customers of LPG HR Coils to increase the sales volumes. (ii) From the year 2012-13 onwards, the MoUs were signed in special quality categories and IFC of up to 60 days was extended to all LPG customers having MoUs under Special Quality category.

[1] ***Hot rolled coils***

Management reply should be viewed in the light that the OBP of special quality material for the year 2012-13 and 2013-14 allowed IFC up to 15 days on monthly lifting of 100 ton and above. Higher level of credit could be considered based on merit, but in this case, off-take of the customer had gradually come down from 54,108 tons to 20,730 tons during 2009-10 to 2013-14. As the lifting of M/s Tirupati Group gradually declined over a period of 2009-14, extension up to 60 days IFC outside MoU conditions during 2012-14 lacked justification.

(b) Delay in decision making resulted in avoidable revenue loss and inventory holding cost

Railway Board issued a tender for procurement of 55,953 tons of stainless steel sheets/plates to manufacture stainless steel wagons in March 2012. SAIL participated in the tender, and in anticipation of order, received 19,993 slabs in 409M grade from Alloy Steel Plant (ASP) Durgapur. Part of these slabs were rolled and kept in-process condition with the intention of immediate supply. The company, however, failed to get the order as its bid of ₹ 74,500 per ton (ex-works) was higher than L-1 price of ₹ 68,850 per ton. Indian Railways (IR) authorized the railway wagon builders (RWB) to procure steel plates through Market Price Authorization (MPA) route from the market for the interim period and Railways were to reimburse them at L-1 rate. Audit observed that in April 2012, Salem Steel Plant (SSP) had an inventory of 24,274 tons of 409M grade slabs, but did not sell to RWBs at ₹ 68850/ton (ex-works) on the grounds that variable cost of the material was ₹ 74,121 per ton. After lapse of 20 months the Board gave approval in December 2013 to sell the same at less than variable cost and SAIL sold the material to RWB at average NSR ranging between ₹ 63,517/ton and ₹ 66,438/ton which was less than the price of ₹ 68,850/ton approved by IR. Thus, due to inordinate delay in taking decision, the company incurred a revenue loss of ₹ 9.47 crore and an inventory holding cost of ₹ 35.72 crore till Nov 2013 which was avoidable.

Management stated that they received majority of quantity of 409M grade steel from IR in previous years on L-1 basis and were anticipating to get their order in the instant case too. Reply is to be viewed against the fact that despite being aware that the material was developed specifically for Railways who was the only major customer and SAIL did not have an alternate market for disposal of these slabs/finished steel, company delayed taking a suitable decision in the context of market conditions and held the materials in stock for more than one year eight months knowing that market value of materials may decrease due to quality deterioration with passage of time. Had the management considered all the aspects which they considered subsequently, they could have avoided revenue loss of ₹ 9.47 crore and an inventory holding cost of ₹ 35.72 crore till November 2013.

5.2.2.8 Trade receivables

Non recovery of interest of ₹18.81 crore from a private buyer

Terms and conditions of the MoU signed between the company and M/s Larson & Toubro Limited (L&T) for the years 2011-12 to 2014-15 included grant of unsecured credit. ₹ 18.81 crore was recoverable from L&T on account of interest on delayed payment for the period 2011-12 to 2014-15 but the company did not recover the same. Management stated that they will recover the amount against turnover discount payable to the buyer in 2014-15. Reply is not tenable as the interest amount was to be recovered on year to year basis. Further, recovery of cumulative interest up to 2014-15 was higher than TOD[1] accrual of ₹ 11.43 crore payable to L&T, and net amount remains to be recovered as on 31 October 2015.

5.2.2.9 Conversion of semis into final product from conversion agencies

(a) Higher revenue realization foregone due to increase in semis

The company did not have sufficient rolling capacity to fully utilize intermediate products like semis to produce the prime product for final use, and capacity additions could not be possible due to 4-5 years delay in completion of company's modernization and expansion projects. Semis (Billets, Blooms and Slabs) have an economic value and are sold to the re-rolling mills. But they have lesser net sales realisation (NSR) than the finished product like TMTs and Structurals of different types ***(Annexure-XXV).***

Audit observed that the company had empanelled the private conversion agencies to convert semis like billets, blooms, slabs supplied from the company's plants and return the value added finished products like TMT, Structural, after conversion. There was also sufficient national demand during 2009-15 for bar and rods (which included TMTs) and structural. Enough capacity for conversion was also available with the wet leasing agents (WLA) and conversion agents (CA) hired by the company which however was not used to the full extent. Conversion of semis into finished products has decreased over the period, and production of saleable semis increased from 2,392 thousand tons in 2009-10 to 3,007 thousand tons in 2014-15. The company thus lost the opportunity to realize higher revenue from value added finished products in all these years.

Management while admitting higher realization from value added finished products stated that the market situation and economics of conversion and sale of semis were considered while taking decision for conversion of semis. Management reply should be seen in the light of the fact that the company reduced the number of CAs and WLAs on roll from 51 in 2009-10 to 32 in 2014-15 thus reducing overall conversion capacity. Contracted capacity of WLA was not fully used and there was increasing retention of saleable semis.

(b) Inadequate supervision over conversion agencies.

The Conversion Agencies (CA), under the arrangement of conversion, had liberty to roll semis supplied from other sources and were not restricted to roll the semis supplied by the company to their premises, whereas under wet leasing arrangement, the entire infrastructure of the WLA was leased for manufacturing the final product from the semis supplied by the company. Conversion Policy and Wet Leasing Arrangement Policy 2009 provided for inspection and supervision of the use of semis and converted products. Nearby BSOs were assigned to supervise the work of each CA and WLA. Audit noted the following instances of misuse of the company's supplies and SAIL brand name by CAs and WLAs.

[1] ***Turnover Discount***

(i) M/s SKS Ispat, Raipur, a CA under supervision of BSO/Bhilai was found (27 September 2011) misusing SAIL brand name but no action was taken except issue of a warning letter. The CA however continued misusing SAIL embossing on products during next 15 months and the company terminated the contract on 28 January 2013. Management replied that a Civil Suit had been filed at Hon'ble Bombay High Court under the Trademark Act for seeking permanent injunction prohibiting the CA from infringement of SAIL Trademark and to recover a loss. The company forfeited ₹ 6.64 crore comprising of security deposit, pending bills for conversion charges and encashment of bank guarantee. Management reply should be seen in the light of the fact that the CA was found misusing SAIL brand second time in March 2012 but the CA was allowed to continue, and action was initiated only after the CA was found misusing SAIL brand the third time in December 2012. The company estimated damages to its revenues and reputation to the tune of ₹ 337 crore[1] and lodged a claim of ₹ 330 crore[2] on M/s SKS Ispat, Raipur. Thus lack of supervision on CA by BSO resulted in estimated undue gain of ₹ 330 crore by allowing him to sell other producers' steel with SAIL brand name. As per conversion policy, the BSO executives were expected to make frequent visits to the CA's premises to inspect proper usage of material but the same was not being done.

(ii) The existing controls over conversion agencies were found in audit to be inadequate or not being implemented effectively. The company detected only few instances of misuse of the SAIL brand name by CAs, after lapse of considerable time due to laxity at BSO level in discharging their oversight responsibilities. Clear demarcation of SAIL's semis with proper paint marking and finished steel with non-SAIL material in CA premises was not ensured. Copies of the agreements between SAIL and CAs/WLAs and between SAIL and RITES (a third party inspection agency) were not shared with RITES and CAs/WLAS respectively which hindered the work of RITES in effective performance of their tasks. The Policy of 100 *per cent* embossing as per branding prescribed by SAIL was not fully implemented. Management replied that the system of supervision of conversion process had been strengthened for strict compliance. Management reply should be seen in the light of the fact that the company has not conducted any study to understand the magnitude of SAIL branded spurious material in the market and sources and modus-operandi of such operation.

(iii) BSO/Vizag did not conduct the required physical verification of stock at M/s Velgapudi Steels Limited Visakhapatnam, a WLA at the end of March 2011 and 2012. In physical verification conducted from 25 April 2012 to 03 May 2012, 1152 tons of steel material valuing ₹ 5.74 crore were found short. Had the branch conducted yearly physical stock verification of 2011 and 2012 on schedule, it could have noticed the shortage in time and stopped further misappropriation of stock. Audit noted that the oversight over the performance of WLA was

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[1] ***Calculated by arriving the unauthorised quantity produced (i.e. total production less quantity produced for SAIL conversion) multiplied by the profit margin or price difference between SAIL and the secondary producers.***

[2] ***₹330 crore claimed after adjusting ₹7 crore from ₹337 crore.***

inadequate. The firm failed to achieve the minimum quarterly guaranteed production of TMT bars during April 2011 to March 2012 and BSO/Vizag issued notices for the payment of penalty of ₹ 7.54 crore. However, BSO/Vizag released conversion bills amounting to ₹ 5.50 crore during 19 July 2011 to 27 April 2012 without recovering the penalty imposed on them. The contract was also not terminated but was allowed to expire on 04 May 2012 at the end of fourth year. Management replied that out of total claim of ₹ 13.28 crore, ₹ 4.98 crore was recovered by way of encashment of BG and bills etc. For the balance amount of ₹ 8.52 crore, the party was not responding favourably and conciliation through a Scope Forum was invoked. Later, the Party sought arbitration. Reply of the company should be considered in the light of the fact that only minor penalty of censure was imposed and administrative warning and caution letter issued to officers responsible for the loss despite serious negligence on their part, and loss of revenue by way of stoppage of supply of TMTs for sale in the southern region.

5.2.2.10 Non fulfillment of Export obligation

Salem Steel Plant (SSP) availed (2008-10) concessional custom duty @ 3 *per cent* under Export Promotion Capital Goods (EPCG) Scheme. The SSP thus saved the custom duty of ₹ 114.55 crore on imports of capital goods and spares imported for SSP's capacity expansion programme. Under the EPCG scheme (11 April 2008), the company was to complete export obligation of ₹ 1987 crore from SSP products by 30 November 2017 which included export obligation of ₹ 993.50 crore i.e. 50 *per cent* of total export obligation from stainless steel products manufactured by SSP and exports from other plants for the remaining export obligation. Though the production facilities at SSP were commissioned by September 2010, total export obligation fulfilled by SSP up to 31 March 2015 was not more than ₹ 45.29 crores. Audit observed that the company had no plans on how to fulfill balance export obligations of SSP and there is a risk that the company would have to pay ₹ 121.42 crore as interest and composition fee on expiry of obligation period besides refund of customs duty of ₹ 114.55 crore saved under the scheme. The management replied that efforts are being made to discharge the Export Obligation of SSP by including the exports of other units of SAIL. Audit however noted that application filed (17 April 2015) by SSP management with Director General of Foreign Trade (DGFT), Coimbatore for including mild steel products produced by SSP and other steel plants of SAIL for discharge of full export obligation of SSP was turned down (4 June 2015) as the case lacked merit. Subsequently, SSP took up the matter (18 June 2015) with DGFT, New Delhi, whose response was awaited as of February 2016.

5.2.2.11 Multiple handlings of semis leading to higher cost

Stock transfer of semis from steel plants to the premises of CAs and WLAs involved handling cost besides freight, and the same was borne by the company. Audit noted that 9.51 lakh ton of semis were first transferred from Bhilai Steel Plant to stockyards at Bhilai and Nagpur; and from Durgapur Steel Plant to stockyard at Durgapur. Later the same was supplied to the CAs and WLAs of BSOs jurisdiction. This resulted in three handlings of material instead of two handlings if semis had been directly transferred from the Steel Plants to CAs/WLAs. Management replied that all the expenses including that of stockyard supplies were taken care of in conversion economics, and cited reasons like logistics and stocks availability for allowing stock transfer from stockyards. Management reply should be seen in the light of the fact that one extra handling meant additional cost and reduced margin from sale of finished product.

Conclusion

Steel consumption in India increased by 30 *per cent* during 2009-15, but SAIL's market share in total saleable finished steel decreased from 18.5 *per cent* to 14.2 *per cent* during the same period. This was not only due to the delays in capacity addition projects, but also due to absence of active dealership base which adversely impacted the growth in retail sales. 39 *percent* to 54 *per cent* of ARDs of the company were inactive. There was no physical verification of ARD's activities by the Branch Offices. Sales through MoUs with large institutional consumers accounted for 92 *per cent* of company's total sales in 2014-15, and developing customer base in retail sector was accorded lower priority. The company was not successful in about 30 *per cent* of the tenders participated by it during the 3 years period from 2012-15 mostly due to its higher bids. No analysis of the reasons for losing business in tenders was being done by the company and no action taken to formulate future action plan. Extension of credit period to M/s Tirupati Group resulted in undue benefits of ₹ 3.98 crore. Interest of ₹ 18.81 crore was not recovered from M/s Larson & Toubro Limited. Inadequate supervision over conversion agencies resulted in instances of misuse of the company's supplies and SAIL brand name by CAs and WLAs. The company could not recover ₹ 8.52 crore from a WLA at Visakhapatanam.

Recommendations

We recommend that the company may consider taking the following measures:

- ***Expand its customer base in retail sector and strengthen the periodical supervision of the activities of Authorised Retail Dealers;***
- ***Analyse the causes of failure in securing orders through tenders and outcome of such analysis may be used while formulating future action plans.***
- ***Improve the performance appraisal of Conversion agents and Wet Leasing Agents.***

The matter was reported to the Ministry (November 2015); their reply was awaited (March 2016).

5.3 Idle investment at SPU Bettiah project of SAIL

Setting up a SPU at Bettiah for conversion of semis into finished steel was not a prudent decision financially and commercially. Resultantly, an investment of ₹ 140.16 crore in the SPU became non-performing and 137 officials specifically recruited for the SPU were idle.

Steel Authority of India Limited (SAIL or company) decided (2007) to set up a Steel Processing Unit (SPU) at Bettiah, Bihar. The Board approved (July 2008) the project at a total cost of ₹ 116.24 crore. The Pipe/Tube mills and facilities for GP/GC Sheets[1] with

[1] Phase-I comprised of Pipe/Tube Mills to produce up to 3" and 3-8" black pipe, and facilities for Galvanised Plain (GP) and Galvanised Corrugated (GC) sheets

annual production capacity of 50,000 ton of pipe and 20,000 ton of GP/GC Sheets were to be installed in Phase I. Phase-I projects could not be completed as scheduled by January 2010. The SPU was finally completed by December 2012 with a delay of about three years at a total cost of ₹ 140.16 crore. Due to the higher cost of production compared to the market price, the company did not increase the production beyond the required level for testing and to keep the mills operational. Production was less than one *per cent* of mills' capacity during 2011-2015. The investment of ₹ 140.16 crore in SPU Bettiah therefore became non-performing and 137 officials (out of initially appointed 145 officials) specifically recruited for the SPU, were idle (January 2016).

Audit observed as follows:

A) Imprudent selection of plant location:

(i) Decision to set up SPU at Bettiah for conversion of semis into finished steel was not financially and commercially prudent. The primary objective of setting up Bettiah SPU was to meet the demand for sized and finished steel near the point of consumption in the state of Bihar. However, the cost of production was expected to be higher for SPU in Bettiah, because the input material was to be transferred from the existing steel plants (Bokaro and Durgapur) in the form of semi-finished steel, thereby adding freight element to the cost of production.

(ii) Separate facilities like residential quarters, guest house, green belt etc. were also to be created at Bettiah due to distance from existing plants. The advantage of apportionment of fixed costs was therefore not available to the unit at SPU.

(iii) Audit also observed that the objective of meeting the required demand could be achieved by installing capacity within the existing steel plants and supplying the products through company's marketing network close to the points of consumption in view of the fact that company had a branch sales office in Patna and 103 authorized retail dealers in 37 districts of Bihar appointed with the sole aim of tapping the demand in local areas. The produce from Bettiah SPU was also supposed to be sold through this marketing network. Against the envisaged capacity of 70,000 ton of pipes and sheets, only 706 ton of pipes and corrugated sheets were produced during 2011-2015, and nearly half of it (366 ton) was used in other steel plants of SAIL. Hence, the stated objective of tapping the demand of rural household/ small consumers by selling the produce near to the point of consumption was not achieved.

B) Idling of staff

The Chief Executive officer of BSL[1] recruited 145 employees against the requirement of 128 employees. These personnel were idle as the SPU has stopped production. Presently there are 137 employees and over ₹ 3 crore per annum (as on March 2015) is being paid towards their salaries and wages. The cumulative expenditure in this regard was ₹ 11.90 crore (April 2009 - October 2015).

[1] ***Bokaro Steel Plant (BSL) is nodal plant for SPU Bettiah***

C) Creation of excess capacity

The SPU required 3.6 MVA for mills in Phase-1[1], however, company purchased (2009) two 5 MVA transformers, each costing ₹ 40.26 lakh, and one DG set costing ₹ 2.11 crore. The second transformer and the DG set has remained unused since the procurement. Further, the company entered into a contract (March 2011) with Bihar State Electricity Board (BSEB) for supply of 1000 KVA for testing and commissioning of Phase-1 mills. Clause-6 of the tariff order of BSEB provided that the transformer capacity of HT consumer should not be more than 150 *per cent* of the contract demand and violation of this is considered a malpractice. Nevertheless, management installed a transformer having a capacity of 5000 KVA instead of 1500 KVA, without corresponding increase in contract demand as there was no scope of higher use of electricity given the underutilization of mills. BSEB charged ₹ 6.44 crore (up to March 2015) for using the higher capacity transformer after issuing a reminder (December 2011). This further increased the cost of production at SPU.

The Board of Directors of the company in its meeting (25 February 2014) noted that the SPU at Bettiah had commenced production but regular commercial production had not started, and that SPU was not viable due to higher cost of production vis-à-vis the market price. Director (Technical) in a review meeting (29 April 2014) opined that sale of SPU at Bettiah would be a better option than closing down the same. This was endorsed by the then Joint Secretary (MoS) and Secretary (Steel) who saw no scope in running this SPU and desired immediate action for disposing of the land and machinery and deployment of personnel to other plants/units. The management, however, has not taken any action for implementation of this decision (January 2016).

The Management in its reply to the Ministry of Steel stated (February 2016) as follows:

(i) The Project was technically feasible, financially viable and hence considered for implementation,

(ii) Expression of Interest (EOI) to run and maintain the Unit had been invited and proposal for issuing Notice Inviting Tenders will be followed after finalization of the terms & conditions,

(iii) the SPU was set up with the social objective of meeting requirement of steel of rural small customers at their doorstep in the state where no steel plant was located,

(iv) Manpower had been working for different activities including security job at different times, and

(v) the transformer has been received at site and is under erection.

The Management reply is not tenable because (i) financial viability of SPU was based on gross margin i.e. net sales realization[1] minus works cost, and works cost did not include administrative expenses like office salaries and other office expenses. Moreover, as per feasibility report (2007), the gross margin in production of GC sheet (₹ 591 per ton on works cost of ₹ 39,259) was very low. Financial viability of investment based on low

[1] ***Net sales realisation = Selling price - cost of sales returns, if any, allowances and discounts.***

gross margin computed on the basis of works cost alone was subject to high risk particularly when the administrative expenses had to be fully absorbed with no scope for apportionment, (ii) the decision of BSL management to obtain EOI to maintain and operate the plant was at variance with the fact that SAIL Board (February 2014) and Ministry (April 2014) had observed that SPU was not viable due to higher cost of production vis-à-vis the market price, (iii) the social objective of meeting rural small customers' demand at their doorstep could not be achieved by SPU due to high production cost on account of negligible production, (iv) the manpower deployed at SPU Bettiah was largely idle as the production was less than one *per cent* of the rated capacity and no steps were taken to redeploy the manpower to other steel plants/units and (v) more than three years elapsed before the Management decided to replace the transformer and order (January 2015) a 1500 KVA transformer for installation. As on January 2016, 5000 KVA transformer had not been replaced and the company continued to bear the avoidable BSEB penalty @ ₹ 5.36 lakh per month.

Thus, setting up a SPU at Bettiah for conversion of semis into finished steel was financially and commercially not a prudent decision. An investment of ₹ 140.16 crore in the SPU therefore became non-performing and 137 officials specifically recruited for the SPU were idle.

The matter was reported to the Ministry (January 2016); their reply was awaited (March 2016).

5.4 Avoidable expenditure

Outsourcing of coal coordination and liaisoning services from a private firm despite having an in-house organisation for the same purpose led to an avoidable expenditure of ₹ 14.35.

Central Coal Supply Organisation, Dhanbad (CCSO) is a service unit of Steel Authority of India (SAIL or the company). The CCSO is responsible for regular coordination and liaison with the subsidiaries of Coal India Limited for supply of indigenous coking and boiler coal to its differently located steel plants as well as power plants run by its joint ventures. The main functions of CCSO included actual assessment of quality of coking coal at loading points through proper sampling and analysis, monitoring of the loading and weighment of coal rakes, finalization of long term and short term agreements with the coal companies, making centralized payment and settlement with the coal companies. Since formation of Bokaro Power Supply Company (P) Limited (BPSCL) in 2001 as SAIL's power joint venture company, the CCSO performed these functions for BPSCL until November 2007, when SAIL allowed BPSCL to outsource these services to a private firm.

BPSCL was formed by transferring the company's existing captive power generation utilities at Bokaro but the captive status of power plant was maintained i.e. SAIL shall purchase entire power and steam produced by BPSCL. The company also signed a Shared Facilities and Support Services Agreement (SFSS) with the BPSCL, and Schedule 3A of this agreement provided for CCSO's assistance free of cost to BPSCL. As the CCSO was providing such services, allowing BPSCL to outsource such coordination and liaisoning services to a private firm did not add any demonstrated value to BPSCL.

Therefore an expenditure of ₹ 14.35 crore incurred from November 2007 to March 2015 on coal coordination and liaisoning activities at an annual average rate of ₹ 1.96 crore was avoidable.

The Management in its reply to Ministry stated (January 2016) that (i) the Boiler coal linkage was transferred in the name of BPSCL in place of SAIL/BSL in December 2006; procurement of coal was taken over by BPSCL in view of the provisions in the Power and Steam Purchase Agreement (PSPA) between SAIL and BPSCL, and decision taken by BPSCL Board, (ii) 30-35 *per cent* of the total coal supplies were from non-conventional sources where there has been no set up of CCSO, (iii) considering coal handling cost of ₹ 35 per ton for coal supplies from non conventional sources linked to BPSCL, and ₹ 5 per ton on supplies from conventional sources, SAIL may have to incur additional expenses of approximately ₹18.50 crore and there would have been saving of ₹ 4.15 crore. Ministry has re-iterated (March 2016) the views of Management.

The reply of Management/Ministry is to be viewed against the following facts:

(i) As per Schedule 3A of SFSS, BPSCL would compulsorily avail the assistance of CCSO/SAIL for coal supply co-ordination after the transfer of coal linkage to BPSCL free of charge, till it makes its own arrangement. CCSO was providing coal coordination and liaisoning support from coal companies to BPSCL free of cost under the same agreement. Under the PSPA between the company and BPSCL, SAIL shall purchase entire power and steam on the basis of reimbursement of fixed and variable charges incurred by BPSCL on generation as well as supply. Therefore, cost of outsourcing such services will add to the cost of power purchased from BPSCL with no corresponding saving in expenditure of CCSO. Transfer of coal coordinating and liaising services from CCSO to the BPSCL was not a pre-requisite for transfer of coal linkage from BSL to BPSCL's name. Paragraph 4.1 of SFSS agreement states that BPSCL could make its alternative arrangement in consultation with SAIL.The company holds 50:50 shareholdings in BPSCL with Damodar Valley Corporation, and appoints its executives on the BPSCL's Board in the same proportion. Therefore, the company's executives on the BPSCL Board needed to evaluate the additional cost to SAIL *vis-a-vis* benefits from outsourcing. This was, however, not done. As stated by BPSCL, it had no stake in this decision as there was no loss to them since cost of outsourcing was reimbursable by SAIL. Moreover, CCSO continued to render the same services to another power joint venture, NSPCL;

(ii) Total coal supplies to BPSCL during 2008-15 period was 8.49 million tonne of coal comprising 7.36 million tonne from conventional and 1.13 million tonne coal (13.3 *per cent* of the total supplies) from non conventional sources;

(iii) Average coal handling cost at CCSO was ₹ 34.68 per tonne during 2008-09 to 2014-15, but 90 *per cent* of the cost comprised employee benefits which is borne by SAIL in any case. CCSO had provided these logistical services to BPSCL since its incorporation in 2001 till 2007 when BPSCL appointed the private firm. BPSCL has failed to provide evidence of additional value or efficiency in its operations on account of engaging a private company. In fact its cost of operation has only increased leading to higher purchase cost of power for SAIL. Further, the saving claimed in the reply is not based on facts.

Thus, outsourcing of the coal coordination and liaisoning services to a private firm despite having an in-house organisation for the same purpose was not necessary, and an expenditure of ₹ 14.35 crore incurred at an annual average of ₹ 1.96 crore was avoidable.