CHAPTER XIV: MINISTRY OF SHIPPING

Dredging Corporation of India

14.1 Operation and Maintenance of Dredgers

14.1.1 Introduction

Dredging Corporation of India Limited (DCI), incorporated in March 1976 is a 'Mini Ratna' Company and is the only Public Sector Undertaking in the field of dredging in India. It is headquartered at Vishakhapatnam. It provides dredging services to create new or additional depths and maintain desired depths in shipping channels of Major and Minor Ports, Indian Navy, fishing harbors and other maritime organisations. DCI's services are put to use for Port development, Reclamation of low lying areas, Beach nourishment, Environmental Protection, Tourism, Flood Control, Irrigation etc.

As of 31 March 2016, DCI possessed 16 dredgers. These included three Cutter Suction Dredgers (CSD)[1] for capital dredging, twelve Trailer Suction Hopper Dredgers (TSHD)[2] for maintenance dredging and one Backhoe Dredger[3] for dredging in tidal areas, ports and alongside jetties.

14.1.2 Audit Objectives

The objectives of the Audit were to assess whether:

a. Dredging assignments were effectively planned and executed in an efficient and economic manner; and

b. Dredgers were properly maintained so as to ensure their optimum utilisation.

14.1.3 Audit Criteria

Audit criteria was derived from the following:

- Five year Corporate Plans for the period 2009-13 and 2014-18;
- Agenda and minutes of the meetings of the Board of Directors;
- Guidelines and directives issued by Government of India (GoI) from time to time;
- Planning documents regarding deployment of dredgers
- Dry dock policy and other manuals/policies laid down by DCI for operation and maintenance of dredgers.

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[1] ***Seven to forty years old with total pumping capacity of 5,000 cum/hr***
[2] ***Two to forty one years old with hopper capacity of 66,970 cum***
[3] ***Five years old with pumping capacity of 370 cum/hr***

14.1.4 Scope of Audit and Sample Size

Audit covered the operation and maintenance of the dredgers during the period from 2010-11 to 2014-15. A total of 59 contracts valuing ₹3511 crore which represented 95 *per cent* of the total value of the contracts entered during the period 2010-11 to 2014-15, were selected for review as below:

(₹ in crore)

Particulars	Total Contracts	Value (₹ in crore)	No. of contracts selected	Value (₹ in crore)	Percentage of selection in terms of value of contract
1.	**2.**	**3.**	**4.**	**5.**	**6 = (5/3)*100.**
Operation of Dredgers	24	3402	21	3265	96
Maintenance of Dredgers	32	277	20	226	82
Purchase of spares	45	26	18	20	73
Total	**101**	**3705**	**59**	**3511**	**95**

14.1.5 Audit Findings

14.1.5.1 Operation of Dredgers

(I) Submission of price bids below estimated cost

For securing dredging contracts, the Marketing Department of DCI prepared the cost estimates considering dredging site plan/conditions, tender conditions, deployment of suitable dredgers, operating costs, overheads and profit margin ranging from 15 *per cent* to 30 *per cent.* These cost estimates were placed before higher management to decide the final price to be quoted.

Audit observed that out of twenty one dredging contracts selected in audit, ten contracts were secured through tenders. In six such contracts, DCI had quoted price below the cost estimates (including margin) prepared by Marketing Department. In fact, in the following three cases, the quoted prices were below the operational cost:

S. No.	Port	Period of Contract	Estimated Cost without margin (₹ in crore)	Price Bid and Awarded value (₹ in crore)	Percentage variation ((5-4)/4)*100
1.	**2.**	**3.**	**4.**	**5.**	**6.**
1.	Cochin Port Trust	2011-12 to 2013-14	132.54 145.83 156.37	104.40 105.30 109.80	-21 -28 -30
2.	Kandla Port Trust	2012-13 and 2013-14	314.75	295.02	-6
3.	Ennore Port Limited	2010-11	206.95	170.99	-17

It was also noticed that DCI was not working out the actual cost incurred for each project/contract. Hence, it was not able to take measures to control costs and improve margins. Audit was, thus, not able to evaluate the performance of the projects undertaken by DCI.

DCI stated (September 2015) that profitability of the projects was being monitored through ERP system from 2015-16 onwards. DCI/Ministry of Shipping (MoS) further stated (March/April 2016) that the price bids were finalized at a lower rate to be competitive and to keep the dredgers in operation so as to earn some contribution over the marginal cost. DCI, however, assured that with the implementation of ERP system, project-wise cost data would be available from 2016-17 onwards.

The reply of DCI/MoS needs to be viewed against the fact that in three out of the above six cases, the quotations were submitted even below the estimated operational cost, which was not justified. Since DCI was in the dredging business for the last four decades, till the time of implementation of ERP, it should have instituted a system of maintaining project-wise cost data to monitor and control the actual costs and improve the margins.

(II) Loss in the contract relating to Ennore Port Limited

Phase-II capital dredging (9.5 million cum) work was awarded to DCI (December 2010) by Ennore Port Limited (EPL) at a contract price ₹170.99 crore and was to be completed within 18 months *i.e.*, before 6 June 2012. However, DCI completed the project only in April 2014 with a delay of 23 months after incurring expenditure of ₹327.72 crore. The revenue realised from EPL was ₹172.33 crore. The overall loss sustained in the contract as worked out by audit, was ₹155.39 crore. In this regard, audit observed the following:

(a) Failure to conduct pre-bid survey and underperformance of dredgers

DCI did not conduct pre-bid survey prior to bidding to ascertain the site conditions, thereby encountering hard strata during execution resulting in dredging at lower pace. Further, DCI dredgers underperformed during the execution. As against the initial planning to deploy three dredgers, DCI had off-loaded (November 2012) 3 million cum to International Sea Port Dredging Limited (ISDL) for contract price of ₹34.80 crore. ISDL actually dredged 3.45 million cum in 41 days for which DCI paid ₹39.41 crore. On the other hand, DCI dredged 7.48 million cum in 661 dredging days. This resulted in loss of ₹131.23 crore.

DCI stated (September 2015) that ISDL executed the soft material whereas DCI tackled very stiff material. MoS endorsed (March 2016) the reply of DCI. DCI/MoS further stated (April 2016) that due to shortage of time, DCI had to rely on the borehole data provided with bid documents by the respective Ports, which generally varies during the execution of the dredging work. Dredgers available with DCI were not capable for dredging at EPL due to different nature of soil and to take-up the capital dredging works. The capacity of the sub-contractor's dredger was higher and cannot be compared with dredgers of DCI.

The reply is not acceptable because the quantum of hard strata was only 1.19 million cum and EPL allowed a higher rate of ₹225 per cum for the hard strata. The fact remained that failure to conduct pre-bid survey coupled with under-performance of own dredgers resulted in loss of ₹131.23 crore.

(b) Improper planning of deployment of dredgers

Against the plan to deploy three dredgers (Dredge XVII, VIII and Aquarius), DCI actually deployed seven dredgers on rotation during the period from February 2011 to April 2014 and incurred total mobilisation/demobilisation expenditure of ₹29.56 crore against the contract price of ₹13.32 crore. Improper planning in deployment of dredgers resulted in additional avoidable expenditure of ₹16.24 crore.

DCI stated (September 2015) that due to dry dock plans and commitments to various other ports, there was change in the deployment schedule. MoS endorsed (March 2016) the reply of DCI.

Reply of DCI/MoS needs to be viewed in the light of the fact that schedules of planned dry docks and commitments to various other ports were well known to DCI. Even then, DCI did not visualise the mobilisation and demobilisation expenditure correctly, while submitting the bids.

(c) Short billing for the work done

Short billing of ₹7.92 crore[1] was observed in Ennore Port Limited (EPL) project for dredging done by Dredge-XV totalling 0.80 million cum in-situ quantity *i.e.*, 0.66 million cum at Outer Approach Channel (OAC) and 0.14 million cum at General Cargo Berth (GCB) during 25 July 2011 to 27 August 2011. Reasons for these were also not on records.

DCI stated (September 2015) that work was done at the request of EPL at GCB which was out of the scope of work and the production was very less due to hard bottom. Before suitable dredger was deployed, there was heavy siltation in OAC area due to monsoon and hence, no claim was preferred. MoS in its reply (March 2016) endorsed the reply of DCI. DCI/MoS further stated (April 2016) that the post dredging survey, though conducted, the same was not made official, since the Port might recover money on grounds of reduction of depths.

Reply is not tenable as Dredge-XV was deployed 25 days after withdrawal of Dredge-XVII. DCI's contention that siltation of 0.80 million cum in a period of 25 days was not logical in view of the fact that when dredging in the same area was carried out in November 2012 *i.e.*, after 15 months, the actual siltation was 0.93 million cum only.

(III) Excess expenditure in dredging at Cochin Port

(a) Mobilisation/demobilisation charges incurred in excess of estimates

DCI had entered (December 2011) into a contract with Cochin Port Trust (CoPT) for three years *i.e.*, 2011-14 for maintenance dredging at a value of ₹319.50 crore. As per the contract DCI was required to deploy two dredgers. DCI had estimated mobilisation/ de-mobilisation charges to the tune of ₹7.50 crore. The contract was extended by one year in April 2014 at a contract price of ₹172.10 crore. However, while extending the contract for 2014-15 (April 2014), no mobilisation and demobilisation charges were estimated.

[1] ***0.80 million cum x ₹ 99 per cum as per the contract***

However, due to frequent changes in deployment of dredgers, DCI incurred total expenditure of ₹23.41 crore on mobilisation/demobilisation against the estimate of ₹7.50 crore resulting in excess expenditure of ₹15.91 crore.

DCI / MoS in its reply (March / April 2016) stated that dry-docking of dredgers cannot be avoided in long term projects and the dredgers need to be shuffled as per the dry dock plan.

The reply of the MoS needs to be viewed in the light of the fact that schedules of planned dry docks and commitments to Ports were known to DCI, as it was a continuous process and deployment of dredgers could be assessed in advance. Therefore, the cost of redeployment/replacement of dredgers should have been considered on a realistic basis while submitting the price bids for mobilisation/demobilisation charges.

(b) Liquidated damages paid for failure in maintaining depth

The contracts with CoPT were depth based lump sum contracts and DCI was required to maintain desired depths in the navigational channel. Failure to maintain desired depth would attract liquidated damages (LD) at the prescribed percentages. Despite deploying more dredgers than those envisaged in the contract, DCI failed to maintain the desired depth due to which from 2011 to 2015, CoPT deducted ₹8.44 crore towards LD.

DCI did not offer any remarks. MoS stated (March 2016) that actual deployment plan will vary as per actual dredging requirement/scope of work at a particular project to meet project time lines and to avoid penalties.

The fact remained that though more dredgers were deployed as against that envisaged in the contract, DCI failed to achieve the desired depths and incurred liquidated damages of ₹8.44 crore.

(c) Penalty for not deploying dredgers of capacity specified in contract

During the period from 2011 to 2015, DCI was required to deploy TSHDs at CoPT with a total hopper capacity of 12,000 cum for minimum period of 25 days in a month during 16 May to 30 September of each year and of a hopper capacity of 10,000 cum for 20 days in a month during the remaining period. Failure to deploy dredgers of required capacity would attract penalty at prescribed rates. Audit observed that CoPT recovered penalty of ₹6.76 crore for the failure to deploy required capacity dredgers. It was further seen that the actual penalty payable was ₹4.36 crore and ₹2.40 crore was paid in excess due to incorrect calculation by the Port.

DCI stated (September 2015) that unanticipated breakdowns and extended dry docks had caused deviation from initial deployment plan and that it would lodge a claim for recovery of excess penalty. MoS stated (March 2016) that actual deployment plan would vary as per actual dredging requirement/scope of work at a particular project to meet project time lines and to avoid penalties.

The fact remains that failure to ensure deployment of two dredgers at any point of time with required minimum hopper capacity resulted in penalty of ₹4.36 crore. Further, DCI

failed to identify the error in calculations at the time of settlement of bill and to take it up immediately with CoPT for recovery of the same.

(IV) Penalty for non removal of backlog quantity in Kandla Port

Kandla Port Trust (KPT) awarded (December 2012) a lump-sum dredging contract of ₹295.02 crore for dredging the navigational channels starting from February 2013 to March 2015. As per the pre-dredging survey after the award of contract, DCI was required to clear 33.21 lakh cum of backlog quantity before the end of the contract for which ₹210 per cum was payable, separately. However, if DCI failed to clear the backlog quantity, penalty at the rate of ₹300 per cum was recoverable by KPT. At the end of the contract, DCI could clear 23.94 lakh cum of backlog quantity leaving a balance of 9.27 lakh cum. Consequently, KPT recovered ₹27.80 crore for the shortfall.

DCI stated (September 2015) that the quantum of backlog was not specified in the tender and not declared by KPT and efforts were on to clear the backlog quantity. MoS in its reply (March 2016) stated that the matter was being pursued with KPT for an amicable settlement. If required, action for arbitration would be initiated. In April 2016, MoS informed that the matter finally was referred to Intra-Ministerial committee for settlement.

(V) Poor performance of newly purchased Dredge XVIII

Dredge XVIII, a CSD, was procured (March 2010) by DCI from Mazagaon Dock Limited (MDL) at a cost of ₹269.58 crore. The delivery was subject to successful trial run. However, in January 2011, the vessel was accepted without successful trial run. Audit observed that the performance of the dredger was poor with a capacity utilisation of only 22 *per cent* till March 2015. It remained inoperative from December 2012 to July 2014. Thereafter, it remained in dry dock till December 2015 and an expenditure of ₹34.21 crore was incurred on dry dock repair during the said period. The dredger remained inoperative for the period from December 2015 to May 2016. In May 2016, it was deployed to take up dredging at Mormugao Port Trust (MGPT) but again it failed to commence work immediately. It started dredging on 18 August 2016 but on 24 August 2016, it again broke down and was yet to be put into operation (December 2016). Thus, taking over CSD without proving its dredging capabilities was not in the best interests of DCI.

While accepting (September 2015) the audit observation, DCI stated that it had encashed the performance bank guarantee of ₹27.37 crore. However, the matter was under Arbitration.

14.1.5.2 Maintenance of dredgers

(I) Idling of dredgers

The following cases of idling of dredgers due to sailing of vessels without ensuring dry-dock slots and expiry of statutory certificates were observed in Audit which resulted in significant loss of revenue:

(a) Docking survey of Dredge XIV in Haldia was due by February 2011 and on the request of DCI which was made in December 2010, Hindustan Shipyard Limited (HSL) allotted dry-dock slot for February 2011. However, instead of utilizing this slot, DCI obtained (January 2011) extension of certificates up to 30 April 2011 from Directorate General of Shipping. Another slot was obtained from HSL in April 2011 but the same was also not utilized and the dredger was deployed for operations at Paradip from 3 April 2011 to 29 April 2011. DCI once again requested (4 May 2011) HSL for dry dock slot in the first week of May 2011, but HSL allotted slot from 23 May 2011. Meanwhile, validity of certificates expired by 30 April 2011 and the dredger was kept idle before it was dry docked on 23 May 2011. Defective planning resulted in idling dredger for 22 days and opportunity to earn revenue of ₹4.14 crore (at the rate of ₹18.81 lakh per day) was lost.

(b) Statutory certificates of Dredge IX were originally valid upto April 2011 and the dredger was to be dry docked in May 2011 for which a slot had been allotted by HSL in March 2011. DCI, however, did not utilize this slot and got the certificates extended from DGS upto 30 June 2011 and the dredger continued to work at Haldia. On 27 June 2011, the dredger sailed from Haldia and reached Visakhapatnam on 29 June 2011. It was observed in audit that HSL, on 27 June 2011, had already intimated through fax about non-availability of dry dock slot and advised to postpone stemming of the dredger to first week of August 2011 and due to which the dredger was not dry-docked. At this point of time, DCI again obtained (7 July 2011) an extension of certificates from DGS upto 31 August 2011. The dredger, however, had to remain idle for 26 days *i.e.*, from 7 July 2011 to 1 August 2011 after which it started working at Visakhapatnam.

Thereafter, in September 2011, DCI placed a work order on HSL for dry docking against which it was allotted slot from 22 October 2011. Consequently, the dredger, again remained idle for a period of 51 days *i.e.*, from 1 September 2011 to 21 October 2011.

Thus, due to failure of DCI to utilize the slot of May 2011 and get the certificates revalidated and sailing the dredger for dry docking without ensuring availability of dry-dock slots resulted in idling of the Dredge IX for a period of 77 days resulting in loss of revenue of ₹11.27 crore (at the rate of ₹14.64 lakh per day).

(c) Without confirmation of availability of dry dock slots from Cochin Shipyard Limited (CSL), Dredge VIII sailed (23 May 2012) from CoPT to CSL for undertaking dry dock repairs. It reached CSL on 23 May 2012, but was allotted the slot from 11 June 2012. Due to this, the dredger remained idle for 19 days resulting in loss of opportunity to earn revenue of ₹2.90 crore (at the rate of ₹15.28 lakh per day).

DCI / MoS stated (September 2015/April 2016) that though dry dock repairs were planned in time, due to operational requirement and contractual commitments, dry-docking schedules were deferred. DCI stated (September 2015) that vessels had to sail out from the Port prior to the expiry date of Statutory Certificates. Hence it had no option but to sail. MoS endorsed (March 2016) DCI's reply.

The reply is not acceptable as DCI should have planned dry docking of the dredgers before expiry of the Classification Certificates which were mandatory for operation of dredgers and should have ensured that the dredgers sailed for dry-docking only against the confirmed availability of slot.

(II) Major damages to Dredge XI

Dredge XI operating at Kochi was stopped on 16 July 2010 due to low lube oil pressure and metal particles found in the crankcase. Investigation by the Engineer of Original Equipment Manufacturer (OEM) revealed that crankshaft was bent out of the specified tolerance and recommended replacement with new crankshaft. Deputy General Manager (Tech) of DCI attributed the damage of crank shaft to (i) over running of bearings (ii) Auto Lube Oil flush system not being in use and filter clogging indicator not being monitored to effect timely filter changes etc. The Executive Committee of DCI also reported that the failure of the crankshaft was mainly due to lack of timely action and not following the Planned Maintenance Schedule (PMS). The Board of Directors (BoD) of DCI, while according approval for estimated expenditure of ₹14.99 crore for repairs of Dredge XI expressed its serious concern over the non-monitoring of the PMS. Afloat repairs were awarded to CSL and repair works were carried out during 26 October 2010 to 25 August 2011 at a cost of ₹13.53 crore.

Audit observed that:

- The auto flush system in Dredge XI was not in use for more than 5 years (since 2005) and DCI made no efforts to carry out the repairs during previous dry-docks of the dredger taken up in July 2006 and in February 2009.

- Dredge XV had also suffered damage in its crankshaft during 2009 for similar reasons. The Original Equipment Manufacturer in its investigation report indicated that due to negligence of maintenance of filter elements of Automatic LO filters, the bearings and the crankshaft were damaged. With this experience and to avoid recurrence of similar failures, DCI immediately took note of it and circulated (22 June 2009) instructions to all CEOs of the dredgers and advised to check auto clean filter elements and to maintain the Lube Oil filters in good condition in their dredgers in future.

- In fact, possibility of damage to Dredge XI was anticipated by General Manager (Technical) who cautioned the dredge officer through email on 22 January 2010 that in case the lube oil system was not in order, the dredge engines were likely to be damaged.

In spite of previous recurrence/advance warning, no timely action was taken to maintain the lube oil filters in good condition resulting in damage to the crankshaft of Dredge XI due to which the dredger was to be under afloat repairs at CSL for 303 days which resulted in loss of opportunity to earn revenue of ₹97.09 crore[1].

DCI /MoS while confirming the audit observation (September 2015/April 2016) stated that failure of Dredge XI engine was only due to failure of main bearings and there was no relation with damage of Dredge XV main engines.

The fact was that in both the cases, common reason for failure of crank shaft was the failure to maintain the auto lube oil filter systems, causing metal particles to have

[1] ***156 days i.e., from 26 October 2010 to 31 March 2011 at the rate of ₹14.02 lakh per day totalling ₹21.87 crore and 147 days i.e., from 1 April 2011 to 25 August 2011 at the rate of ₹51.17 lakh per day amounting totalling ₹75.22 crore***

encountered the crank shaft. No remedial measures were initiated to ensure auto lube oil filters were in working condition, even though BoD advised to maintain the auto lube oil filter system properly for all the dredgers. Thus, failure to rectify the defective auto lube oil filter system in time and non-monitoring of PMS schedule had resulted in major damage to Dredge XI.

(III) Detention of Dredge XI

During the Flag State Inspection (FSI)[1] of Dredge XI, Mercantile Marine Department (MMD) of Directorate General of Shipping, highlighted (18 February 2014) 38 deficiencies out of which 8 were reported as detainable. Consequently, the dredger was detained from 18 February 2014. DCI complied with the deficiencies on 12 March 2014 and the dredger resumed work from 13 March 2014. Audit observed that the detainable deficiencies[2] were easily identifiable and should have been rectified by DCI before inviting MMD for inspection. Thus, defective planning resulted in stoppage of dredger for 23 days with loss of opportunity to earn revenue of ₹5.85 crore (at the rate of ₹25.44 lakh per day).

DCI stated (September 2015) that date of inspection of the dredger was deferred at the request of MMD and after short notice the inspection was carried out by MMD. MoS did not offer any remarks.

The reply of DCI is not acceptable. MMD had inspected the dredger on 18 February 2014 as against the request of DCI to conduct the inspection on 30 January 2014. Since, FSI is an annual exercise, DCI should have complied with requirements by rectifying deficiencies before inviting MMD for inspection.

Conclusion

Due to delays in execution of dredging contracts within the stipulated time period, DCI had to sustain loss on account of recovery of liquidated damages by the Ports. Defective planning in mobilisation/de-mobilisation of dredgers was observed, which resulted in avoidable expenditure and consequent reduction of margins. DCI lost the opportunity to earn considerable amount of revenue due to failure to revalidate statutory certificates of the dredgers. Further, acceptance of dredger without successful trial run and failure in following the Planned Maintenance Schedules resulted in their non-utilisation for a considerable period.

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[1] ***The flag State of a trading ship is the State under whose laws a ship is registered or licensed. The flag State has the authority and responsibility to enforce regulations over ships registered under its flag. It is also responsible for the conduct of the ship towards safety and environment protection. Flag State Inspection (FSI) of Indian flag ships are conducted by the Mercantile Marine Department of the Directorate General of Shipping.***

[2] ***Like no batteries in walkie-talkies, incomplete log book, expiry of MOB marker, no audible alarm for navigation light panel, accumulated oil leaking, bilges covered with oil/water/sludge, non working of steering flat emergency talk system etc.***

Recommendations

DCI should aim for enhancement of its dredging capability through better planning, efficient deployment and supervision so as to ensure completion of work within the stipulated period. It may also ensure revalidation of statutory certificates in time so as to avoid their idling. Delivery of dredgers should be taken after successful trial runs. Further, DCI may ensure that the Planned Maintenance Schedule is strictly adhered to so as to avoid sudden breakdowns.

The Shipping Corporation of India Limited

14.2 Loss due to failure to restore interest payment clause

Failure of the Management to restore the interest payment clause deleted by SBI while renewing the bank guarantees resulted in loss of interest of ₹19.24 crore

The Shipping Corporation of India Limited (SCI) entered (October 2007) into a contract with M/s. Bharati Shipyard Limited (BSL), Mumbai for construction of one 80 Tonne Anchor Handling Tug-cum-Supply Vessel (Hull No.395) at a price of USD 22.32 million. SCI was to make stage payments as per the payment schedule incorporated in the contract against unconditional, irrevocable refundment guarantee issued by the State Bank of India or reputed international banks acceptable to SCI plus interest at seven per cent per annum.

SCI paid ₹82.17 crore (between October 2007 and September 2010) in five instalments to BSL for Hull No.395 as advance payments against four bank guarantees issued by State Bank of India (₹60.83 crore) and one bank guarantee issued by Andhra Bank (₹21.34 crore).

As per the shipbuilding contract, Hull No.395 was scheduled to be delivered on 15 August 2010, which was extended upto 30 September 2013. The bank guarantees were also extended till November 2013. However, even after the extended delivery date, BSL could not deliver Hull No.395. SCI, therefore, rescinded the contract on 1 October 2013 and invoked (17 October 2013) the bank guarantees.

On invoking the bank guarantee, Andhra Bank paid (29 October 2013) ₹28.46 crore including interest. However, SBI paid (23 December 2013) only the principal amount of ₹60.83 crore. Interest amounting to ₹19.24 crore[1] was not paid. SCI took up the matter (April 2014) with SBI for payment of interest, but SBI informed (August 2015) that no interest was payable on the bank guarantee as the extended bank guarantee did not provide for payment of such interest. SCI took up (March 2016) the matter with Department of Financial Services (DFS) through Ministry of Shipping. DFS / SBI intimated (May 2016) that as per the legal opinion of the Law Department of the bank and opinion obtained from an external Senior Counsel, the claims honoured by the bank were in order and interest was not payable. The Company is pursuing with SBI to resolve the issue but no further progress has been made (September 2016).

Audit observed that the original bank guarantees issued by SBI provided for payment of interest at the rate of seven per cent per annum. However, when the bank guarantees were

[1] ***At the rate of seven per cent per annum as per the contractual terms from the date of issue of bank guarantee to 23 December 2013***

extended, SBI removed the clause relating to payment of interest. The amended bank guarantees, thus did not have clause for paying interest to SCI. This amended guarantee agreement was accepted by SCI and it did not take up the matter of restoring the interest payment clause in the amended bank guarantees with SBI. The loss could have been avoided had the Company taken up the matter with SBI when the bank guarantees were renewed without clause relating to payment of interest.

The Management stated (September 2016) that (i) SCI has never consented whatsoever for any deletion/omission of clause in the bank guarantee to SBI; (ii) the shipbuilding contract clearly provided for obtaining express consent; (iii) the original bank guarantee issued by SBI had the interest clause as enumerated in the contract and subsequent renewals of the shipbuilding contract were only to be a mere extension of date to cover the delay in the delivery of the vessel; (iv) covering letters accompanied with all the extended bank guarantees issued by SBI clearly stated that all terms and conditions appearing in the original guarantee shall apply to the extension and shall be read with the original guarantee and citing the amendment details that have been carried out in the guarantee with all other terms and conditions remaining the same and SBI was liable to pay the interest as there has been a delay and consequential cancellation of the shipbuilding contract.

The reply of Management is not acceptable as:

(i) It was pointed out (August 2016) by SBI that the deletion of interest portion was not by mistake but was a deliberate omission done with the implied consent of SCI as SCI accepted the extended/amended guarantees without raising any objection or dispute;

(ii) The shipbuilding contract was between SCI and BSL, SBI was not a party to the shipbuilding contract and it was the responsibility of SCI to ensure that appropriate interest clause was included in the guarantee agreement to secure its own interest;

(iii) Amended bank guarantees did not contain a clause relating to payment of interest and the omission was not taken up by SCI in time with SBI for restoring the same.

The Ministry of Shipping stated (February 2017) that (i) the original bank guarantee issued by SBI had the interest clause and the subsequent renewals of the bank guarantees in accordance with the ship building contract were only to be a mere extension of date to cover the delay in the delivery of the vessel and the contention of SBI that deletion of interest clause portion was a deliberate omission done with implied consent of SCI is not valid; (ii) Notice of assignment of refund guarantor provided that no variation or amendment or release or waiver shall be effective unless the assignee agreed to it; (iii) SCI does not accept that there has been an omission of the clause relating to payment of interest and even if there has been an omission, the same is of a clerical nature which does not have any legal sanctity and cannot change the character of the document; and (iv) In view of limitation period coming to an end, SCI has moved the Bombay High Court for recovery of the deficit amount, which is awaiting listing.

The reply of the Ministry is not acceptable as the extended/amended bank guarantees did not contain provision for payment of interest and SCI failed to notice the absence of the interest payment clause in the extended/amended bank guarantees which could have avoided unwanted dispute and legal complications.

Thus, failure of the Management to ensure restoration of the interest payment clause deleted by SBI while renewing the bank guarantees resulted in loss of interest of ₹19.24 crore.

14.3 Management of Agency Agreements

14.3.1 Introduction

The Shipping Corporation of India Limited (SCI/Company) was formed in October 1961 by amalgamating Eastern Shipping Corporation and Western Shipping Corporation. The Company's operations are divided into four major segments viz. (a) Liner segment; (b) Bulk segment; (c) Technical and offshore services segment; and (d) Others segment. As on 31 March 2016, the Company's fleet consisted of 69 vessels with 5.89 million dead weight tonnage. The Company operated through a network of 78 agents at various Indian and foreign ports. The duties and responsibilities of the agents were prescribed in the Model Agency Agreement, which was last revised by the Company during the year 2008. As per this agreement, the agents carry out marketing functions, book cargo on behalf of SCI and also collect freight for Liner division.

14.3.2 Audit objectives and scope

An audit paragraph on "System of collection and accounting of freight and other charges from agents of SCI" was included in Report No. 9 of 2007 of the Comptroller and Auditor General of India. This highlighted the ineffectiveness of the Company in ensuring compliance with the terms of agreement with agents regarding opening of separate collection and disbursement accounts, timely submission of voyage accounts and furnishing of bank guarantee. In the Action Taken Notes submitted on this paragraph, the Ministry had stated (September 2010) that implementation of a new ERP package would reduce delay in submission of voyage account and that bank guarantees were being collected. Ministry had also stated (March 2015) that Global Cash Management System had been introduced since 2007, which would ensure opening of separate collection and disbursement accounts.

In the context of these assurances, a follow up audit was conducted to assess (i) the extent of compliance with the provisions of Agency agreement, (ii) the system of obtaining bank guarantee from agents, and (iii) the system of performance evaluation of agents. A period of five years from 2011-12 to 2015-16 was covered in audit.

14.3.3 Audit findings

14.3.3.1 Non-compliance with the provisions of Agency agreement

(I) Non-maintenance of separate disbursement account and separate freight account

As per Articles 11 (a) and (c) of the Agency agreements, the agents had to maintain a separate disbursement account for funds remitted by SCI to them for attending to vessels. The agents were also to open a separate account for crediting the freight and all other dues payable to SCI. The Article (b) of the agreement stipulated that the agents would furnish a copy of the bank's statement of the disbursement account for the previous month to SCI.

In 2007, the Company introduced a Global Cash Management System (GCMS) which envisaged opening of freight collection accounts and disbursement accounts by the agents at all major ports in the name of SCI and operation of a central pooling account for automatic sweeping of funds from the freight accounts.

Audit observed that:

(i) Out of 78 agents, only 21 agents opened separate disbursement accounts and out of 66 freight collecting agents, only 27 agents opened separate freight accounts under GCMS.

(ii) Two agents (viz. M/s Oceanmasters, Dubai and M/s Escombe Lambert Limited, United Kingdom and Ireland), who were covered under GCMS did not remit the freight collected by them during the period 2011-14. SCI terminated the agreements with these agents in March 2015 and October 2014 respectively. However, these agents are yet to remit the entire freight to SCI, the amount outstanding as on 31 March 2016 from these two agents being ₹9.80 crore and ₹28.60 crore respectively.

(iii) Fifty seven agents did not open separate disbursement and freight collection accounts under GCMS. They also did not furnish bank statements of their disbursement accounts every month, for the previous month, as mandated by the Agency agreement. Further, 39 agents did not open separate freight accounts. These agents collected freight in their own names and transferred it to SCI at a later date. It was noticed that the Company had done away with audit of the accounts of these agents by Certified Public Accountants, which was in vogue till the year 2008.

Thus, the Company failed to ensure that GCMS served its intended objective of efficient fund management. The Company also failed to ensure that agents comply with their obligations regarding disbursement and freight collection accounts under the Agency agreements signed with them.

The Management stated (February/April 2016) that there were locations where the freight account could not be opened due to local laws of the country. However, the freight was normally remitted by the agents to the account nominated by the Company. It was also informed that due to huge delay in settlement of freight accounts, the agency agreements with both M/s Oceanmasters and M/s Escombe Lambert Limited were terminated.

The reply of the Management needs to be viewed against the fact that collection of freight in their own accounts by the agents and subsequent transfer to SCI at a later date defeated the very purpose of introducing GCMS. It also entailed loss of interest for the time taken in remitting the freight collected.

(II) Delay in submission of final disbursement account

The Company introduced (February 2011) Systems, Applications and Products in data processing (SAP) through which the proforma disbursement accounts submitted by agents were processed and advance payments were made to them.

As per Article 11 (g) of Agency agreement, the agent shall forward a complete voyage disbursement account for each ship of SCI handled by the agent within 35 days of sailing of the vessel. After approval of the account by SCI, advance given to the agent was to be adjusted against actual expenditure. The Company had the right to levy penalty upto USD100 for each day of delay in uploading the accounts.

Audit observed that there was no system in place to ensure that the agents uploaded the voyage disbursement accounts within the prescribed time. Further, the Company did not levy any penalty for delay in uploading the accounts.

The Management stated (February/April 2016) that a particular voyage account could be cleared only after the entire invoice lines of that voyage were cleared. As a result, there were backlogs. Further, the Company had introduced (December 2014) auto closure of accounts within three months from the date of sailing of the vessel.

The reply is not acceptable as a time limit of 35 days was provided to an agency as per agency agreements for submitting the accounts, beyond which penalty was leviable. Auto closure after 90 days would imply allowing an additional 55 days to the agency for which a penalty of upto USD 5,500 (USD 100 per day X 55 days) could be levied as per the agency agreements. As per the data furnished by the Company, there were 837 auto closures from December 2014 onwards for which no penalty has been levied. Thus, the Company failed to levy penalty of upto ₹30.54 crore in these cases for delay of agents, beyond the stipulated 35 days, in submitting accounts to the Company.

(III) Non-conduct of special audit

As per Articles 11 (h) and (l) of the Agency agreement, the Company had the right to carry out special audit at its sole discretion for which the agent was to fully co-operate. Further, the Company had the right to inspect the books of accounts and relevant records at the agent's premises.

Audit observed that the Company did not conduct special audit of any of its agents till the year 2014. During July 2014, the Company deputed teams of its officials for inspection of three agents viz. M/s Escombe Lambert Limited (agents at United Kingdom and Ireland), M/s Karl Geuther& Company (agent at Antwerp, Germany) and M/s Muller Agencies (agent at Rotterdam, The Netherlands). However, all the three agents denied complete access of their books and bank accounts to the teams deputed by the Company in violation of the provisions of Agency agreement. Based on the limited records made available, the teams noted several deficiencies such as incorrect invoicing to shippers, delays in invoicing, substantial differences between revenue collected from shippers and the revenue passed on to SCI, etc. On the basis of these findings, the agency agreement with M/s Escombe Lambert Limited was terminated (October 2014) while no action was taken in other two cases.

While accepting the audit observation, the Management stated (February 2016) that a tender had been floated to entrust the audit of agents to independent auditors. Accordingly, the Company has appointed (October 2016) independent auditors for audit of books of accounts maintained by the Agents.

14.3.3.2 Non-obtaining of adequate bank guarantees from agents

The procedure for appointment of agents (April 2006) provided that bank guarantees be obtained from agents on the basis of estimated volume of disbursements to them. Further, the Company decided (January 2010) that the bank guarantee should cover the risks involved in delay in collection and deposit of freight by the agents over and above the normal credit period allowed to them. Accordingly, the quantum of bank guarantee should be based on previous one year's average outstanding amount beyond the credit period allowed to agents.

In case of 12 major agents[1], Audit observed that:

(i) While working out the amount of bank guarantee to be obtained from agents during the year 2015-16, the Company considered the outstanding amount as trade receivables from the agent *minus* trade payables to the agent. These trade payables included certain amounts (aggregating to ₹69.12 crore) which were to be disallowed to the agents. This resulted in under-estimation of the bank guarantee amount by ₹69.12 crore.

(ii) The amount of bank guarantees actually available with the Company did not bear any relation even with the amounts incorrectly worked out by the Management. As against the bank guarantees of ₹43.50 crore required to be obtained from the agents, an amount of ₹8.92 crore only was available with the Company as on 31 March 2016.

The Management stated (February 2016/ September 2016) that bank guarantee was a deterrent and only partially mitigated the risk. Further, the bank guarantees were obtained from those agents where there was business and continuous exposure.

The reply is not acceptable. By under-estimation of bank guarantee amount and obtaining even lower bank guarantee, the Company failed to protect its financial interests, as intended by the decision taken in January 2010.

14.3.3.3 Non-monitoring of performance of agents

The Audit Committee of the Company directed (March 2004) the Management to evolve a system for performance evaluation of the agents for submission to the Board of Directors. The performance evaluation was to be based on factors such as (i) marketing/ solicitation of cargo, (ii) freight collection/reconciliation, (iii) financial and accounting matters, (iv) husbanding including handling floating staff members, and (v) spare parts and repairs coordination. The purpose of performance evaluation was to induct excellence into the professional conduct of agency management, to serve as a tool of Management Information System, to consider giving bonus to outstanding agents and to decide on the continuity/ termination of the below average agents.

Further, the Board directed (August 2008) that the performance evaluation of agents should also contain analysis in respect of (a) variation in the business/ revenue generated

[1] ***Ameaster Shipping and Trading Company, Cesare Fremura SRL, De Keyser Thorton NV, Far Eastern Services PTE Limited, Far Eastern Services SDN BHD, Hesco Agencies Limited, Marti Shipping Agency SA, MorskaAgencia Gdynia SP, Muller Liner Agencies BV, Seaster Shipping Lines, Champion Agencies China Limited and General Maritime Private Limited***

over the previous year, (b) variation in the performance over the previous evaluation period, (c) extent of outstanding to/from SCI, and (d) specific issues/ specific achievements, etc.

Audit observed that:

(i) Performance evaluation of agents for the periods upto June 2012 only had been submitted to the Board of Directors. After completion of the performance evaluation, the agents were informed about their ranking, scores and deficiencies observed and were advised to improve thereupon.

(ii) Though the evaluation for the periods upto December 2013 was carried out, it was not submitted to the Board for want of information relating to agents. The evaluation for subsequent periods was not carried out by the Company (March 2016).

(iii) The Company did not include many critical parameters in the performance evaluation of agents, such as delay in freight remittance, delay in submission of accounts, duplication/overcharging of claims and resultant disallowances, non-reconciliation of port deposits, etc.

While accepting the audit observation on non-availability of complete information, the Management stated (December 2015/ September 2016) there was a need to redesign the process of performance evaluation which was also a reason for not presenting the evaluation to the Board.

The reply is not acceptable as the need for redesigning the performance evaluation process cannot be taken as a ground to dispense with the existing system. Till the system was redesigned, the Company should have carried out and submitted the performance evaluation report as per the existing system.

14.3.3.4 Non-revision of model Agency agreement

After the introduction (February 2011) of SAP ERP system, some of the requirements under the financial and accounting clauses of the existing Agency agreement had become redundant. It was, therefore, imperative that the Company review the Agency agreement to remove such redundancies. The Standing Committee of the Company had also decided (February 2015) to review all the clauses of the Agency agreement. So far, even after lapse of five years from the implementation of SAP ERP system, the final decision in this matter was yet to be taken by the Management (September 2016).

Conclusion

The Company did not enforce maintenance of separate disbursement and freight collection accounts, timely submission of final disbursement accounts and conduct of special audits of agents despite enabling provisions in the Agency agreements. Besides, the Company failed to protect its own interest by obtaining lower bank guarantees from the agents than mandated by its own policy. There was a backlog in performance evaluation of agents with Company not submitting performance evaluation of the agents to the Board since June 2012. The existing model Agency agreement had also not been reviewed to address redundancies in the agreement on account of SAP implementation.

The matter was reported to the Ministry in October 2016; their reply was awaited (January 2017).