

Chapter - II

2. Compliance Audit Observations on Public Sector Undertakings

This chapter deals with Compliance Audit Observations on Public Sector Undertakings (PSUs). Important findings emerging from audit that highlight deficiencies in planning, investment and contract management in the PSUs are included in this Chapter.

Karnataka Power Corporation Limited

2.1. Non-achievement of intended objective

The quarters built at Bellary Thermal Power Station at a cost of ₹ 118.46 crore did not serve its purpose due to non-occupation by the employees.

Karnataka Power Corporation Limited (the Company), which has three power generation units (capacity of 1,700 MW¹²³) at Bellary Thermal Power Station¹²⁴ (BTPS), decided (January 2010) to construct staff quarters in a proposed full-fledged township¹²⁵ nearer to the power plant for accommodating its employees who were residing in Bellary city, 25 kilometres away from the plant.

The construction, taken up in July 2010/September 2011, was completed at a total cost of ₹ 118.46 crore in May 2016/May 2017. The quarters were ready for occupation in May 2017. The Board of Directors of the Company approved (September 2017) for allotting the quarters to the employees with effect from October 2017. The Board also approved to discontinue certain special allowances¹²⁶ granted to encourage employees to opt for working at BTPS during initial stages of establishment of BTPS. The employees, however, refused (February 2018) to occupy the quarters on the grounds of close proximity to the power plant and unsuitability to human habitation, absence of facilities for education, health, *etc.* As a result of refusal to occupy the quarters by the employees, the Company had reversed its decision of discontinuing free transportation facility and stoppage of special package¹²⁷ based on the representations received from the associations. The Company leased (September 2020) out the quarters to JSW Steel Limited, which had its integrated steel plant nearby BTPS, at a lease rent of ₹ 38.54 lakh per month.

In this connection, Audit made (March 2019/January 2021) the following observations:

¹²³ BTPS has three units, 2x500 MW and 1x700 MW commissioned in October 2007/January 2012 and September 2016 respectively.

¹²⁴ Situated at Kudithini village of Bellary District which is 25 kilometres away from Bellary Town.

¹²⁵ Comprising 594 quarters (18 tenements of A2 type residential buildings, 12 blocks of Type B and 12 blocks of Type C quarters - each block containing 24 tenements), VIP Guest House (12 suits), Corporate Guest House (24 rooms) and Non-Corporate Guest House (24 rooms).

¹²⁶ HRA at the rates applicable to Bangalore city, special package of ₹ 3,000 per month and free transport facility.

¹²⁷ The Company decided to pay special package at reduced rates of ₹ 770 per month with effect from February 2020.

- i. The Board while taking decision (January 2010) to construct quarters did not deliberate the representations (January 2009 and June 2009) of employees' associations¹²⁸ of the Company which had objected to building quarters nearer to the power plant citing reasons such as, lack of education facilities to the children, health hazards due to air and noise pollution, safety concerns, *etc.* However, these concerns were discussed subsequently in a meeting held (April 2010) with the Managing Director, and conveyed to the associations that there was utmost necessity of employees residing closer to the project site for operation of the thermal plant and also stated that the selected location of quarters was conducive for living.
- ii. Even after completion of quarters, the employees refused (February 2018) to occupy the quarters on the same grounds (lack of education facilities to the children, health hazards due to air and noise pollution, safety concerns, *etc.*) raised at the proposal stage of quarters. The Company having decided to construct the quarters stating that it was an utmost necessity, failed to address the concerns of employees and to persuade them to occupy the quarters built at significant capital investment of ₹ 118.46 crore. Further, the Company continued to incur recurring expenditure of ₹ 7.20 crore¹²⁹ per annum on free transportation and HRA, despite availability of quarters.
- iii. The Company, belatedly after more than a year of refusal (February 2018) by the employees to occupy the quarters, explored (May 2019) the option of leasing out the quarters. Responding to the proposal, JSW Steel Limited expressed (July 2019) interest in taking over the existing facilities on rent or lease basis. However, the Company finalised the lease agreement with JSW Steel Limited only in September 2020, after fourteen months from the date of receipt of its consent, thereby losing the potential lease rental. After considering reasonable period of six months' time for negotiation and finalising the agreement, the Company had lost the opportunity of realising lease rent of ₹ 3.08 crore during January 2020 to August 2020.

The Government replied (August 2021) that the delay in concluding the agreement with JSW was due to negotiation on lease rent and nation-wide lockdown imposed during March 2020 on account of Covid 19 pandemic. Further, it was replied that, even if employees were residing in the quarters, ₹ 2.92 crore was to be incurred inevitably towards conveyance of Executive Engineer (EE) and above cadre for attending to emergency works. Considering this, actual recurring cost works out to ₹ 4.28 crore against ₹ 7.20 crore worked out by audit, and hence there would be saving of ₹ 0.34 crore, taking into account annual lease rental of ₹ 4.62 crore. It was also stated that 96 flats were

¹²⁸ KPC Graduate Engineers Association, KPC Mechanical Engineers Association and KPC Diploma Engineers Association of BTPS Region.

¹²⁹ Included annual HRA of ₹ 2.83 crore calculated based on the amount paid to employees during 2017-19 and actual transportation cost of ₹ 4.37 crore incurred during 2019-20. Payment of special package is not considered for recurring cost as it was paid to encourage employees to work in the power plant.

allotted to Karnataka State Industrial Security Force (KSISF), thereby the Company has partly met the purpose of construction of quarters.

The contention that nation-wide lockdown and negotiation of lease rent led to delay in finalising the agreement is not acceptable, as JSW conveyed its willingness to occupy quarters as early as July 2019, *i.e.* seven months prior to nation-wide lockdown. Secondly, the conveyance charges even for EE and above cadre for attending to emergencies could have been much lesser if the employees were residing in quarters, as the employees at present were transported from Bellary Town (25 km away from project). The Company while arriving at savings of ₹ 0.34 crore did not consider expenditure of ₹ 2.83 crore on HRA, there would be loss of ₹ 2.49 crore. Thirdly, though 96 out of 594 quarters (16 *per cent*) were allotted to KSISF, the fact remained that larger objective of accommodating the employees nearer to the project area for operation of the plant was not achieved.

As the Company depended largely on borrowed funds for its operations and in view of the apprehensiveness of employees occupying the quarters, investment of significant funds (₹ 118.46 crore) lacked justification.

Audit recommends that the Company while making decisions on all such capital intensive projects may ensure to consider the necessity and factors influencing such decisions.

The management stated (February 2022) that the recommendations made by Audit have been noted and will be taken care of in future.

Bangalore Electricity Supply Company Limited

2.2. Amendment of pre-qualification criteria in the tender to favour a contractor

Amendment of pre-qualification criteria in the tender curtailed the competitive bidding and award of contract at higher rates regarding procurement of LT Aerial Bunched cables at an additional expenditure of ₹ 65.34 crore.

Bangalore Electricity Supply Company Limited (the Company), which involved in distribution of electricity in the State, procures various materials through tendering, *viz.* Aerial Bunched (AB) cables, Underground (UG) cables, Transformers, Conductors, Poles, Insulators, *etc* for carrying out its capital and operation and maintenance works (construction of substations and lines, strengthening of existing distribution network, service connections, *etc*). The Board of Directors of the Company/the Central Purchase Committee¹³⁰ (CPC) was the authority for approving the tenders and award of contracts.

The Company procured a total of 3,731 KMs of Low Tension (LT) Aerial Bunch (AB) Cables valued at ₹ 173.16 crore¹³¹ during the period 2014-15 to

¹³⁰ CPC, constituted (August 2016) to bring about uniformity in pre-qualification criteria on material purchase by ESCOMs, has its members (Managing Directors and Directors Technical) from all the five ESCOMs.

¹³¹ [50 KMs × ₹ 3.22 lakh (Tender. BCN-67/2014-15)] + [700 KMs × ₹ 4.10 lakh (Tender. BCP 846/2014-15)] + [2,981 KMs × ₹ 4.80 lakh/₹ 4.76 lakh (Tender. BCP-1040/2017-18)].

2019-20 for capital works. The Company also implemented Integrated Power Development Scheme (IPDS) a contract with LT AB cables as one of the components of work during the same period. Audit scrutinized the tendering and procurement of LT AB cables during the above period and observed that the prequalification requirements of the bidders in the two tenders were amended as discussed below.

The Company floated two tenders as indicated in the table below:

Table No.2.2.1: Details of tenders on procurement of LT AB cable

Sl. No.	Tender I	Tender II
1	No. BCP-846/2014-15/ February 2015	BCP-1040/2017-18/September 2017
2	Quantity: 700 KMs	Quantity: 2,981 KMs
3	Contractor: M/s.SBEE Cables (India) Ltd, Bangalore	Contractor: M/s.SBEE Cables (India) Ltd, Bangalore
4	Award price: ₹ 4.10 lakh/KM	Award price: ₹ 4.80 lakh /₹ 4.76 lakh/KM
5	Total contract price: ₹ 28.70 crore	Total contract price: ₹ 142.85 crore

Audit observed that the tenders for procuring other materials (other than LT AB cables, *i.e.* ACSR Conductor, Transformers, UG cables, *etc*) had a condition that *'bidders should have obtained orders from any ESCOMs of Karnataka / any electrical utilities in India at least 50 per cent of tendered quantity'*. However, this condition was modified by removing *'any electrical utilities in India'*. This modification of condition restricted majority of the bidders from participating in the tenders who had not supplied to ESCOMs in Karnataka. However, this suited the lone bidder (M/s.SBEE Cables (India) Ltd) who had supplied LT AB cable to BESCOM/HESCOM in the previous years. These amendments resulted in undue favour to a single firm, hence, purpose of tendering was not met. The amendment in tender condition was approved (September 2015/July 2017) by the Board of Directors/Central Purchase Committee resulted in undue favour to a single firm.

Audit observed that there were other suppliers¹³² in the market who could supply LT AB cables at cheaper rates, the prevailing market rate per KM was ₹ 2.40 lakh¹³³ during 2017-18 and 2018-19. These contracts were awarded to other suppliers other than M/s.SBEE Cables (India) Ltd. The restrictive tender clause on pre-qualification requirement curtailed the competitive bidding which led to procurement of material at much higher rates (*i.e.* 100 per cent) than that prevailed in the market. The Company procured 2,981 KMs of LT AB cable SBEE Cables (India) Ltd, Bangalore at the quoted rate of ₹ 4.80 lakh/₹ 4.76 lakh per KM, as against the prevailing market rates of ₹ 2.40 lakh per KM. Considering the prevailing market rates, the Company incurred an additional expenditure of ₹ 65.34 crore¹³⁴ on procurement of 2,981 KMs of LT AB Cable against the Tender No. BCP-1040/2017-18¹³⁵.

¹³² M/s. Paramount Communications, M/s. Gujarath, Apar Industries, M/s. Gujarath, Laser Power & Infra Pvt. Ltd, M/s. Howrah, Dynamic Cables, Jaipur, M/s. Insucon Cables & Conductors (P) Ltd, M/s. Jaipur and Alpha Communications Ltd., Ghaziabad, *etc.*

¹³³ This rate represents the cost of procurement of LT AB cable by the contractors from various manufacturers for the works executed under IPDS during 2017-18 and 2018-19.

¹³⁴ 2,385 KMs × ₹ 2.19 lakh + 596 KMs × ₹ 2.20 lakh (extra cost per KMs represents difference between quoted and market rate after considering tender premium of 8.62 per cent).

¹³⁵ Additional expenditure in the previous Tender no. BCP-846/2014-15 has not been quantified in the absence of prevailing market rates.

The Government replied (January 2022) that the prequalification criteria were finalised by the Central Purchase Committee in its meeting held on 22 June 2017 for more participation of bidders. It was further stated that the prices quoted by the bidder in total turnkey contracts *vis-a-vis* an absolute supply contract are not comparable. The basis for prevailing market rate of ₹ 2.40 lakh per km considered by audit is not forthcoming.

The reply is not acceptable as the amendment in prequalification criteria did not result in more participation as intended, instead it facilitated the restrictive participation by a single bidder. The prevailing market rate of ₹ 2.40 lakh per km considered by audit represents the cost of procurement of LT AB cable by the contractors from various manufacturers for the works executed under IPDS during 2017-18 and 2018-19. The rate at which contract was awarded by BESCOM (₹ 4.80 lakh per km) was two times of the prevailing market rate. Moreover, the Company had no means to ensure that the rates quoted by SBEE Cables (India) Ltd were competitive in the absence of wider participation.

Audit recommends that the Company should standardise the pre-qualification criteria of the bidders for procurement of materials to ensure wider participation in the tenders. Any relaxation in the criteria should be made with due justification only after approval of the competent authority

Mysore Sales International Limited

2.3. Construction of Karnataka Bhavan – idle investment and loss of revenue

Lapses on the part of the Company in execution and operation of Karnataka Bhavan at Navi Mumbai resulted in non-achievement of stated objective, time and cost overruns, idle investment of ₹ 36.89 crore and loss of revenue of ₹ 1.31 crore.

The City Industrial Development Corporation Limited (CIDCO), Government of Maharashtra granted lease (June 2000) of 2,520 square metres at Vashi, Navi Mumbai to the Government of Karnataka (GoK) for constructing a State Guest House (Karnataka Bhavan), with a maximum permissible floor space index (FSI) of 1.0. GoK entrusted (March 2005/June 2006) the work for construction of Karnataka Bhavan to Mysore Sales International Limited (the Company).

The Company, after inviting tender, awarded (March 2008) the contract for construction of Karnataka Bhavan to M/s Klassic Constructions Pvt Ltd at a cost of ₹ 18.18 crore to be completed by May 2009. However, the construction was stopped midway after incurring an expenditure of ₹ 7.19 crore (37 per cent completed), as the Company decided (March 2010) to modify the design of the building to accommodate a star category guest house with FSI of 1.5, in view of the developments in the vicinity of Karnataka Bhavan¹³⁶. Navi Mumbai

¹³⁶ International Exhibition Centre, proposed International Airport at Vashi

Municipal Corporation (NMMC), however, rejected (February 2011) the request of the Company for sanctioning additional FSI of 0.5.

The Company thereafter revised the estimate of the balance work of ₹ 12.07 crore¹³⁷ to ₹ 22.55 crore with FSI of 1.0 and a fresh work order for resumption of work was issued in December 2013 (after lapse of 34 months of rejection by NMMC) to the same contractor (M/s. Klassic Constructions Pvt Ltd) to be completed by October 2014. However, the work was completed in March 2018 at a total cost of ₹ 36.89 crore¹³⁸. Thus, the project was completed after 18 years of allotment of plot by CIDCO.

The Committee on Public Undertakings (COPU) after *suo motu* reviewing the project implementation, recommended (October 2013) *inter-alia* fixing responsibility on the officers concerned for revising the designs with higher FSI without any justified reasons and without approvals from appropriate authority, and to complete the construction as per the prevailing norms at minimum cost.

Audit reviewed the operations of Karnataka Bhavan after its physical completion, observations are given below:

The Company, after inviting (July 2018) request for proposal, entered (September 2018) into a Lease and License Agreement with M/s. Athitheya Kshema Hotels Pvt. Ltd (Licensee), Bangalore (the Licensee) for operation and maintenance of Karnataka Bhavan for a lease period of 15 years. The agreement stipulated payment of monthly lease rental of ₹ 16.39 lakh by the Licensee with a provision to enhance the rent annually by 5 *per cent*. The Company handed over the possession of the building to the Licensee in February 2019 with a communication that the moratorium period of four months would commence from 1 April 2019.

Audit observed that the moratorium period was extended twice, upto December 2019 initially and then to April 2020, based on the request of the Licensee for completion of interior works¹³⁹ of the building. Despite breach of terms of the lease agreement, the Company did not exercise the option of terminating the agreement (*Clause 3 & 3.1*) upon three months' notice to the Licensee. Instead, moratorium period was extended by nine months (August 2019 to April 2020) beyond the stipulated period without payment of lease rent for the extended period. Thereby, the Licensee was given advantage, as the Company lost the lease rent of ₹ 1.31 crore¹⁴⁰ receivable as per the lease agreement during the extended moratorium period between August 2019 and April 2020. Besides,

¹³⁷ Original awarded cost of ₹ 18.18 crore *less* work done ₹ 7.19 crore plus additional work of ₹ 1.08 crore.

¹³⁸ Included Cost of land (₹ 76.90 lakh), Additional lease premium (₹ 1.66 crore) and Construction cost of ₹ 34.45 crore (including Architect fee, Project Management Consultancy, *etc*).

¹³⁹ As per the Lease and License agreement, the Licensee was allowed to carry out the work of renovation in the premises including installation of furniture, fittings, equipments and appliances for business purpose.

¹⁴⁰ At the rate of ₹ 16.39 lakh per month from August 2019 to March 2020. Loss is restricted upto March 2020, due to pandemic.

the Company had to incur avoidable recurring charges (₹ 46.54 lakh¹⁴¹) on electricity charges, *etc* which otherwise should have been borne by the Licensee as per the agreement (*Clause 5.2*). The Licensee had sought for further extension of moratorium upto May 2021¹⁴², the decision on this was pending as on June 2021.

The Company failed both at the execution stage and operation stage of the project, whereby the project completion was delayed by nine years (May 2009 to March 2018) from the scheduled date as per the contract entered (March 2008) into with M/s. Klassic Constructions Pvt Ltd, owing to stoppage of work midway and revision in designs with FSI of 1.5 without prior approval of NMMC. The delay resulted in cost escalation including avoidable payment of compensation of ₹ 1.95 crore to the contractor. Further, the Company lost lease rent of ₹ 1.31 crore due to extension of moratorium beyond the period specified in the lease agreement. The Company is also likely to lose further lease rent of ₹ 1.97 crore during June 2020 to May 2021¹⁴³, as the Licensee had sought further extension of moratorium upto May 2021.

Thus, the entire investment of ₹ 36.89 crore remained idle without any return for the last 39 months since its completion (March 2018), as the operations had not been commenced (June 2021). Besides, the stated objective of Karnataka Bhavan, *viz.* providing guest rooms, centre for holding social and cultural activities, art gallery, exhibition centre, outlets for promotion of speciality foods of Karnataka, display of products of Karnataka, *etc* has not been achieved even after 21 years of acquiring the plot in June 2000.

The Government replied (December 2021) that the payment of compensation of ₹ 1.95 crore to contractor is for bonafide reasons and not intentional. The procedural wrangles had caused the delay. The Board of Directors took decision (September 2021) to collect the rent with effect from January 2022 and also to collect the entire arrears of rent with interest from lessee in a phased manner at ₹ 4.00 lakh every month in addition to the regular rent payable from the lessee.

The fact remains that modifying the design midway and stopping work without approval of NMCC caused unwarranted delays in completion of the project. The recovery of arrears as decided by the Board would be subject to consent from the lessee.

Audit recommends that the Company should institute an adequate control mechanism to monitor the project implementation and its operation and maintenance with reference to the terms of contract. The Company may take immediate action to either collect the legitimate lease rental from the Licensee or terminate the lease as per the provisions of lease agreement and retender, so as to avoid further loss of revenue. The Company may also take action to fix the responsibility on the officers concerned for lapses as recommended by COPU.

¹⁴¹ Represents actual amount paid by the Company on security and electricity for October 2018 to October 2019. Agreement is silent on security charges, yet company paid ₹ 25.59 lakh.

¹⁴² Source: Audit Committee meeting held in November 2020 and meeting of Board of Directors held in March 2021.

¹⁴³ April 2020 and May 2020 was not considered due to nation-wide lockdown.

Mysore Sales International Limited

2.4. Infructuous expenditure

Launching of a new product under the brand name ‘Soundarya’ without assessing its demand in the market and violation of various statutory provisions and contract agreement had rendered an expenditure of ₹ 68.88 lakh infructuous.

Mysore Sales International Limited¹⁴⁴ (the Company), with a view to strengthen its product line, envisaged (July 2016) introduction of herbal soaps and other personal care products under its own brand name, viz. ‘Soundarya’. In line with the said decision, the Managing Director of the Company directed (September 2016) its Consumer Product Division to carryout a study for the product demand in the market by employing a professional agency. The Company, after conducting random survey among its employees and clients by distributing the samples of herbal products¹⁴⁵, invited (October 2016) a tender on item rate basis for manufacture and supply of herbal body soaps (10 variants), herbal body wash, face wash and herbal shampoo (three variants) to be launched in the market under its brand ‘Soundarya’.

After holding price negotiation, letters of award were issued (January 2017) to the two lowest bidders, viz. M/s. Vinod Kumar & Brothers Private Limited (M/s. VKBPL) for supply of herbal soap (10 variants) and body and face wash (two variants) and M/s. Matxin Labs Private Limited (M/s. MLPL) for supply of three variants of shampoos¹⁴⁶.

Subsequently, in April 2017, the Company decided to procure 21 additional variants (transparent body soaps and other personal care products), which were not part of the tender. Accordingly, the Company entered (May 2017) into an agreement with M/s. VKBPL for manufacture and supply of 33 variants (including 21 additional variants) and issued (May 2017) a purchase order for ₹ 2 crore to that effect.

Further, the Company placed (January 2018) an indent for initial supply of 19 variants valued at ₹ 60.32 lakh out of 33 variants for which purchase order was issued to M/s. VKBPL. Against which, M/s. VKBPL supplied (July 2018) the products worth ₹ 39.53 lakh. The Company, out of the supplies made by M/s. VKBPL, had distributed the products worth ₹ 9.97 lakh as sales promotion and sold ₹ 1.89 lakh worth of products before expiry of their shelf life (May/June 2019). The balance stock valued at ₹ 27.67 lakh remained unsold and their shelf life stood expired.

In this connection, Audit (February 2021) made the following observations:

¹⁴⁴ The Company, a State Government public sector undertaking, is a marketing organization dealing with various products and services (Chit fund, beverages, paper, consumer products, etc).

¹⁴⁵ The Company spent ₹ 9.47 lakh towards developing product formula and advertisement.

¹⁴⁶ The Company did not pursue the letter of intent issued to M/s. MLPL, without any reasons on record.

- i. The Company, before inviting tender, did only a random survey among its employees and clients by distributing the samples of herbal products, instead of conducting market study as directed by the MD, which would have given a better picture of its demand. It was observed that out of the supplies made by M/s. VKBPL, the Company had distributed the products worth ₹ 9.97 lakh as sales promotion and sold only ₹ 1.89 lakh worth of products before expiry of their shelf life (May/June 2019);
- ii. As per the Rule 12 (3) of KTPP Rules, 2000, security deposit was to be taken from the successful tenderer as a guarantee of the tenderer's performance of the contract. However, there was no evidence on record for having collected the security deposit from the successful bidders as a guarantee for the contract performance, thus violating the said rules. In the absence of any security, the Company had left with no means to recover the loss/damages from the supplier although the supplier defaulted in supply, M/s. VKBPL supplied the products worth ₹ 25.30 lakh against the indent of 19 variants valued at ₹ 60.32 lakh;
- iii. As per the agreement, payment by the Company was to be made to the supplier on the 31st day from the date of delivery at the godowns of the Company. However, the Company, in violation of agreement, released (May/June 2017) an advance of ₹ 50 lakh equivalent to 25 per cent of the ordered value against the security of post-dated cheques and an additional amount of ₹ 21.27 lakh to meet the cost of mould, dyes and design/plate. Further, release of advance against post-dated cheques in place of bank guarantee was in deviation from the General Financial Rules and the conditions of standard tender document¹⁴⁷ issued by the Government of Karnataka. Release of advance without obtaining bank guarantee was also in violation of guidelines issued (February 2011) by the Central Vigilance Commission;
- iv. M/s. VKBPL supplied (*vide* invoice dated 18 July 2018) the products worth ₹ 39.53 lakh which included the products valued at ₹ 14.23 lakh not indented¹⁴⁸ by the Company. Audit observed that the Company on 25 October 2018 informed M/s. VKBPL regarding supply of non-indented products, to which the supplier responded in negative stating that such discrepancies should have been brought to notice within seven days of delivery of products as per *Clause 11* of the agreement. As the Company informed the supplier about the supply of non-indented products after lapse of 99 days against seven days from the date of taking delivery of products, it had incurred loss of ₹ 14.23 lakh. On the other hand, the Company could not sell these products in the market;

¹⁴⁷ *Clause 42* of KW-4 stipulated that the employer shall make payment to the contractor against an unconditional bank guarantee in a form acceptable to the employer issued by a Nationalized/Scheduled Bank in amounts equal to the advance payment. The guarantee shall remain effective until the advance payment has been repaid.

¹⁴⁸ Soudarya orange soap 75 gm, Soudarya transparent soap (lemon), Soudarya baby soap (berberries and calendula), Soudarya hand wash (antibacterial).

- v. The Company did not invoke the provisions of the agreement¹⁴⁹ to levy penalty for non-supply of balance indented products valued at ₹ 24.70 lakh¹⁵⁰ (out of ₹ 60.32 lakh indented) immediately after lapse of 30 days from the date of indent allowed for supply. To a legal notice served in July 2020 for non-supply of indented products, *i.e.* after lapse of two years of supply, the supplier denied (August 2020/September 2020) charges levelled in the notice stating that the supplies were made as per the terms and also issued ‘stop payment’ instructions to their bankers against the post-dated cheques given as security. The Company, however, did not initiate any further action to counter the supplier’s stand. Evidently, the Company could not safeguard its financial interest in the absence of the bank guarantee.

The Government replied (August 2021) that:

- a detailed market survey was conducted by the Company in Karnataka, Delhi and Mumbai where it had branches and the result was very good.
- advance payment against post-dated cheques was released upon a special request by the supplier as he had invested huge funds on production of items. Further, bank guarantee was not collected at that time since it was only on test marketing basis.
- based on the direction of the Minister for Commerce and Industries Department, launching of Soundarya soap by the Company was kept in abeyance in view of Karnataka Soaps and Detergents Limited (KS&DL) was involved in manufacturing and marketing soap products.

The reply is not acceptable. There were no survey reports available on record to justify that detailed survey was conducted except a random survey among its employees and clients. There was nothing on record in support of the fact that response to the product was good.

Advance payment was in violation of conditions of agreement. Moreover, there was no specific exemption to release advance against post-dated cheques for test marketing purpose. The Company failed to safeguard its financial interest by not obtaining bank guarantees before releasing advance. It was a known fact that KS&DL was an existing Government enterprise which was set up for manufacture and marketing soap products. Hence, launching of soap under its brand ‘Soundarya’ without considering this fact was not justified.

Thus, the Company failed to ascertain the product demand in the market prior to its launch, violated various statutory provisions and terms of agreement by awarding the contract without obtaining performance guarantee, releasing advance to the supplier without valid security, and not levying penalty for

¹⁴⁹ Clause 15 (c) of the agreement stipulated levy of penalty at the prevailing bank interest rate on the value of shortfall in supplies after expiry of 30 days from the date of indent.

¹⁵⁰ Advance paid to supplier (₹ 50 lakh) less value of supplies (₹ 25.30 lakh) after adjusting non-indented supplies of ₹ 14.23 lakh.

default of supplies. These lapses had rendered the expenditure of ₹ 68.88 lakh¹⁵¹ infructuous.

Audit recommends that the Company may conduct proper market survey before venturing into new line of business and ensure compliance to statutory requirements and provisions of agreements on advance payment to the contractors to protect the financial interests of the Company.

Karnataka Soaps and Detergents Limited

2.5. Extra expenditure

The decision of the Company for purchase of Pleat Wrapping Machine at a higher price from a sole manufacturer/supplier on the grounds of reduced operating speed resulted in avoidable excess expenditure of ₹ 1.08 crore.

Karnataka Soaps and Detergents Limited (Company) was a manufacturer of personal care products¹⁵² including Mysore Sandal Soaps. The Company, hitherto, was undertaking the process of wrapping of bath soaps through manual operation using hand wrapping machines. As the demand for the product had increased and in order to reduce manpower, the Company decided to mechanise the process of pleat wrapping by procuring automatic pleat wrapping machine. The Board of Directors (Board) of the Company accorded approval (September 2016) for procuring an automatic Pleat Wrapping Machine. The Board, while approving the proposal, noted that the Company made inquiries with the vendors who deal with pleat wrapping machines and found that M/s. Bakubai Ambalal, Mumbai (a division of M/s Oriental Enterprises Private Limited) was the sole dealer who deals with the pleat wrapping machines in India manufactured by M/s. Sasmariani Tommasso, Italy (previously owned by M/s. Guerez, Italy).

The technical specifications of the machine including operating speed (150 pleat wraps per minute) was finalised keeping in view the brand of the machine manufactured by M/s. Sasmariani Tommasso, Italy. The Company invited tenders (five times between November 2016 and March 2017), for supplying Pleat Wrapping Machine with operating speed of 150 pleat wraps per minute. The five tenders, (except fourth call), were not considered as they were single bids, viz. M/s. Oriental Enterprises Private Limited (M/s. OEPL). There were no reasons on record for not considering the bid of M/s OEPL in the previous four tenders, in spite of noting the fact that M/s OEPL was the only dealer for supplying the pleat wrapping machine manufactured by M/s. Sasmariani Tommasso, Italy.

In the sixth tender call invited during May 2017, M/s. OEPL was again the sole bidder (*vide* offer letter dated 29 May 2017). This time, the Company negotiated and placed (11 September 2017) the purchase order on M/s. OEPL

¹⁵¹ Total advance paid to supplier (₹ 50 lakh) less value of supplies including non-indentured products (₹ 39.53 lakh) plus expired stock (₹ 27.67 lakh) plus expenditure on developing product formula, advertisement and cost of mould, dyes and design/plate (₹ 30.74 lakh).

¹⁵² Detergents, Fragrances, Talcum powder, Hand washes, Face washes, Coconut oil, etc.

at a price of ₹ 2.90 crore. The Company also released the advance of ₹ 87.08 lakh (30 *per cent* of the cost) on 19 October 2017. Subsequently, M/s. OEPL informed (December 2017/February 2018) the Company that the machine proposed to be supplied (Model PL-150) could achieve the operating speed of 120 pleat wraps per minute (against the specified 150 pleat wraps per minute) for the soap samples supplied by the Company. The firm also informed that machine could achieve specified operating speed of 150 pleat wraps per minute for 'banded' soaps. Therefore, M/s. OEPL requested the Price Negotiation Committee (PNC) of the Company to amend the purchase order dated 11 September 2017 changing the specification of machine as 120 pleat wraps per minute. As the required operating speed was not met, the Price Negotiation Committee of the Company headed by Deputy General Manager (P&M) discussed on 3 March 2018 the request (February 2018) of the supplier for amending the purchase order did not agree but decided to cancel the purchase order and to go for fresh tender.

Audit observed (May 2020) that the tender specifications did not mention the type of the soap (banded or bandless), it only specified product size in terms of diameter and thickness. Further, the offer letter dated 29 May 2017 of M/s OEPL against the sixth tender had mentioned that the Model PL-150 pleat wrapper was designed to wrap around 150 round and oval side 'banded' tablets (soaps). It was not clear from the records made available to audit that whether the technical parameters with regard to type of soap mentioned in the offer letter were considered before accepting the bid.

Moreover, PNC's decision to reject the request of M/s OEPL to amend the purchase order to facilitate supply of machine with reduced operating speed (120 pleat wraps per minute) was not judicious, as there was no alternative source of supply, the fact of which was noted by the Board and was also evident from the single bids received in the previous four tenders. Furthermore, the Company had subsequently issued (February 2019) fresh work order on M/s. OEPL for procuring the same machine with 120 pleat wraps per minute at a cost of ₹ 3.98 crore, higher by ₹ 1.08 crore over the previous purchase order placed. It clearly indicated that the Company had no objection in purchasing the machine with reduced operating speed of 120 pleat wraps per minute and hence the decision to reject earlier offer of M/s. OEPL (December 2017/February 2018) was not justified, which resulted in unwarranted extra expenditure of ₹ 1.08 crore, due to time overrun.

An advance of ₹ 96.05 lakh was also released (November 2019) to M/s. OEPL as per the terms of work order and the balance was to be released after commissioning. M/s. OEPL delivered the machine in February 2020, against the scheduled date of November 2019. The penalty of ₹ 19.90 lakh¹⁵³ for the delay at the rate of five *per cent* of the contract value had not been levied. Further, the machine has not been put into use yet, the Company was still in the process of commissioning the machine (September 2021).

The Government replied (December 2021) that Price Negotiation Committee, after receiving confirmation from M/s. OEPL that their principal supplier (original manufacturer) was not able to increase the speed from 120 pleat wraps

¹⁵³ Contract value of ₹ 3.98 crore × 5 *per cent*

per minute to 150 pleat wraps per minute, decided to cancel the purchase order (September 2017) and to go for fresh tender. With regard to type of soap, it was stated (August 2021) that the samples of soap for which pleat wrapping was required were made available to M/s OEPL during technical presentation. It was also stated (September 2021) that the machine has not met the required production capacity during trial run carried out in April 2021 and M/s. OEPL was in the process of rectifying the same.

The reply is not acceptable. The Company was aware that there was single source of supply in the global market. In spite of this, the Company rejected the offer of M/s OEPL for supply of the machine with 120 pleat wraps per minute through an amendment of the existing purchase order (11 September 2017) and procuring the same machine subsequently from the same supplier (M/s OEPL) at higher price was not justified. Though the samples of soap were stated to have been given to M/s. OEPL during technical presentation, the fact remained that the Company failed to ensure that the machine had achieved the required operating speed before accepting the bid.

Though the Company incurred an excess expenditure of ₹ 1.08 crore, yet the objective of reducing the manpower by automation of wrapping process had also not been achieved even after lapse of more than five years since its conception (2016 to 2021). Further, the amount of ₹ 96.05 lakh paid to M/s. OEPL as advance also remained unproductive as the machine has not been put to use since February 2020.

Audit recommends fixing of responsibility on the price negotiation committee whose decision led to procurement of pleat wrapping machine at higher price.

Mangalore Electricity Supply Company Limited

2.6. Undue favour to a contractor

The decision of the Company to bear the service tax liability which was in contravention to the tender conditions resulted in extension of undue favour to the contractor by ₹ 97.46 lakh

Mangalore Electricity Supply Company Limited¹⁵⁴ (the Company) invited tender (May 2013) for construction of Corporate Office at Mangalore at an estimated cost of ₹ 12.36 crore. As per the conditions of the tender¹⁵⁵, all duties, taxes and other levies payable were to be included in the tender and the rates quoted by the contractor were deemed to be inclusive of sales tax and other taxes payable for the performance of the contract. No extra payment on this account was allowed to the contractor. The Company also clarified in the pre-bid meeting (July 2013), to a query on recovery of service tax, that all taxes as per the prevailing orders of the Government/the Company were deductible from the bills.

The work was awarded (October 2013) to the lowest bidder, viz. Sri Prabhakar Yeyyadi (the Contractor) at his quoted rate of ₹ 13.71 crore, revised to ₹ 18.53

¹⁵⁴ A State Electricity Distribution Company.

¹⁵⁵ Clause 11.3 of Instructions to tenderers, Clause 39.1 of Conditions of Contract, Clause 9 and Clause 10.2 of Additional conditions/guidelines to bidders.

crore after entrusting (May 2015/July 2015) certain additional works¹⁵⁶. The work was completed in February 2017 at a total cost of ₹ 18.43 crore.

The total cost of ₹ 18.43 crore included service tax of ₹ 97.46 lakh paid to the contractor. The payment of service tax was made based on the request (February 2015) of the contractor that the estimated cost put to tender did not include service tax component. The Executive Engineer (EE-Civil) of the Company, while proposing the request of the contractor, mentioned (February/March 2015) that the estimate put to tender did not include service tax, the contractor informed that his quote was not inclusive of service tax and that no specific clarification was given with regard to service tax while inviting tenders. This proposal was recommended by the Controller of Accounts (Internal Audit) and approved (April/September 2015) by the Managing Director of the Company.

Audit observed that the proposal of EE (Civil) that no clarification was given with regard to service tax while inviting tender was factually incorrect, as the Company during pre-bid meeting (July 2013), where the Contractor was also present, furnished specific clarification. This aspect was not mentioned in the proposals of EE (Civil)/Controller of Accounts (Internal Audit). Further, the contention that the estimate put to tender did not include service tax was not relevant, as the contractor was required to quote his offer inclusive of all taxes, as per the conditions of contract (*Clause 11.3* of Instructions to Tenderers and *Clause 39.1* of Conditions of Contract). Moreover, as per the Special Conditions of Contract, the Company had an option to refer the matter to the arbitrator in case of dispute or differences arising between the Company and the Contractor. However, the Company did not exercise this option.

The Government replied (January 2022) that service tax was not considered while preparing estimate and evaluation of tenders. In the pre-bid meeting, it was clarified that all taxes would be recovered from the bills as per prevailing orders at the time of tender, and there was no specific mention about service tax. 'All taxes' means, VAT, labour cess, EPF, ESI, *etc.* but not service tax.

The Company's contention is not acceptable. It was immaterial that the estimate was not inclusive of service tax, as the tender conditions stipulated that "all duties, taxes, and other levies payable by the contractor under the contract or for any other cause, shall be included in the rates, prices and total tender price submitted by the tenderer". Also, the Company clarified on recovery of service tax in the pre-bid meeting. Moreover, tender document did not define that 'All taxes' does not include service tax, as contended in the reply.

Therefore, the decision of the Company to bear the service tax liability on the ground that the estimate put to tender did not include service tax and no clarification was given at the time of inviting tender resulted in violation of tender conditions and extension of undue favour to the contractor by ₹ 97.46 lakh.

Audit recommends fixing responsibility on the personnel concerned for not apprising the management of pre-bid clarification with regard to recovery of service tax.

¹⁵⁶ Construction of additional floor, compound wall, formation road, *etc*

Karnataka Road Development Corporation Limited**2.7. Undue benefit to contractors**

The Authority paid early completion bonus of ₹ 63.63 crore to the Concessionaires in contravention of provisions of the Concession Agreements.

The Karnataka Road Development Corporation Limited (Authority) and three Concessionaires¹⁵⁷ signed (December 2015) three Concession Agreements (CA) for development of 180.59 km to two-lane standard¹⁵⁸ in 730 days. Article 28.1 of the CA provided for payment of early completion bonus (ECB¹⁵⁹) to the concessionaires only after completion of the total project highway. As per the Article 15.1 of CA, the Two Laning Standard¹⁶⁰ shall be deemed to be complete when the Completion Certification (CC) or Provisional Certificate (PC) is issued by the Independent Engineer and the date of issue of CC or PC shall be the Commercial Operation Date (COD) subject to fulfilment of conditions laid down in Schedule 'I' & 'L' i.e., Road Safety Audit and tests conducted by third party but did not provide for ECB on partly completed work.

The KRDCCL paid ECB of ₹ 63.63 crore to the Concessionaires based on IE's recommendation that the COD was achieved six months prior to TLSD. The details of road length entrusted, due date for completion to get bonus, date of issue of PC, effective date of COD considered, bonus paid etc., are shown in the Table.

Table No. 2.7.1: Details of roads considered for payment of bonus

Package No	Total road length in Km	Name of the concessionaire	Two – laning Standard Date (TLSD)	Due date of completion for becoming eligible for bonus	Date of issue of PC by IE for partial completion	COD considered/ Effective date of PC as certified by IE	Road length certified by IE as completed as per PC (in Km)	Bonus equivalent to one Annuity amount paid (₹ in crore)
WCP-3	73.69	M/s – DBL Hassan Periyapatna Tollways Ltd	28/9/2018	28/03/2018	06/04/2018	28/02/2018	71.94	26.28
WCP-5	55.693	M/s – DBL HirekerurRanibennur Tollways Ltd	29/9/2018	29/03/2018	30/03/2018	24/02/2018	50.071	19.62
WCP-6	51.206	M/s – DBL Mundaragi Hunugund Tollways Ltd	28/9/2018	28/03/2018	31/03/2018	05/02/2018	45.43	17.73
Total	180.589						167.441	63.63

Scrutiny of records revealed that the conditions prescribed in the CA for early completion were not fulfilled and bonus paid was irregular for the following reasons:

¹⁵⁷ M/s.DBL Hassan Periyapatna Tollways Ltd, M/s DBL Hirekerur Ranibennur Tollways Ltd and M/s DBL Mundaragi Hunugund Tollways Ltd.

¹⁵⁸ Low volume traffic highways.

¹⁵⁹ Bonus is equal to one annuity instalment when project is completed before six months or more prior to Two Laning Standard Date.

¹⁶⁰ The construction and completion of all works included in or constituting a Two-Lane Standard Project Highway.

- In case, the Scheduled TLSD was to be proposed to be completed by the Concessionaires earlier than the milestones fixed (Schedule 'G'), the Concessionaires should notify revised milestones for approval by the Authority duly recommended by the IEs for (i) arranging to conduct tests (ii) appointment of consultants for undertaking Safety Audit of the project highways (iii) initiating tender process for levy of toll from the approved revised date of completion. Audit noticed that the milestones were not revised. Thus, the need for conducting tests and appointing consultants by the Authority for undertaking Safety Audit with reference to the revised completion date did not arise.
- The date of issue of PC shall be the COD of the project. However, in all these cases, PCs were proposed by IEs by declaring project highways provisionally fit for entering into commercial operation for prior dates instead of on the actual date of issue of PC¹⁶¹. Moreover, the Authority too approved the PCs and made them valid retrospectively by accepting prior dated CODs which were proposed by the IEs. This was clearly a violation of the CA provisions.
- Had the Concessionaires submitted the revised milestones and got it approved by the Authority, the Safety Audit and tests specified could have been planned and completed for issue of PC before six months i.e., before the due date eligible for receiving bonus. If that had been the case, reckoning COD with retrospective date would not have arisen. Hence, Audit is of the view that the criteria was changed only to facilitate payment of bonus.
- None of the articles of the CA provided for payment of bonus for provisionally completed projects. The article governing payment of bonus (Article 28.1) clearly specifies that bonus would be paid if the project was completed six months or more prior to Scheduled TLSD.

Thus, bonus was not admissible and payment of ₹ 63.63 crore made towards the same was irregular.

In reply, Managing Director, Karnataka Road Development Corporation Limited (September 2021) stated that,

- Concessionaires of contracts WCP 3, WCP 5 and WCP 6 had completed the work on site handed over within 8 months of appointed date and requested IEs to issue PC (16/11/2017). The IE, Concessionaire and representative of the Authority had jointly conducted all tests required including the Safety Audit.
- The date determined by the IE upon tests being successful on the completed highway shall be the date of provisional completion. Due procedure had been followed prior to giving concurrence to IE to issue the PCC with prior date for the purpose of COD.

¹⁶¹ PCs issued on 6th April or 30th March or 31st March 2018 by recording the effective date as 28th or 24th or 5th February 2018

The reply is not acceptable as:

- The fact remains that the Authority did not plan for early completion and hence milestones set originally were not altered.
- As per the CA, it was the responsibility of the Authority to appoint consultants for undertaking Safety Audit and issue PC only after compliance to the findings by the Concessionaires. The Safety Audit done by Concessionaires cannot be considered as valid in terms of provisions of Article 14.1.2 of CA.
- As per the CA, the date of issue of PC by the IEs was the criteria and there was no provision in the CA for considering a pre-dated COD with retrospective effect. Thus, the concurrence given for issue of PCs with a prior date for COD was irregular and payment of bonus for partially completed projects was inadmissible.

The matter was referred to the Government (August 2021); their reply is awaited.

Bengaluru
The

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Accountant General (Audit-II)
Karnataka

Countersigned

New Delhi
The

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