CHAPTER II

PERFORMANCE REVIEWS RELATING TO GOVERNMENT COMPANIES

2.1 REMOVAL OF OVERBURDEN IN OPENCAST MINES OF THE SINGARENI COLLIERIES COMPANY LIMITED

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2.4 INTERNAL CONTROL SYSTEM IN STATE FINANCIAL SECTOR UNDERTAKINGS - ANDHRA PRADESH STATE FINANCIAL CORPORATION AND ANDHRA PRADESH INDUSTRIAL DEVELOPMENT CORPORATION LIMITED

2.1 Removal of Overburden in opencast mines of the Singareni Collieries Company Limited

Highlights

The company had 14 working and three closed mines as on 31 March 2006. The outsourcing of OB removal work was introduced in 1991 and the expenditure towards OB removal for the last five years ended 31 March 2006 ranged between 23 and 25 *per cent* of the total expenditure of the Company. More than 70 *per cent* of OB removal work was outsourced in five to eleven mines in each year. The Company had no clear cut stated policy for outsourcing of OB removal.

(Paragraphs 2.1.1 and 2.1.7)

Despite revision of stripping ratios and outsourcing there was backlog of OB removal in six OC mines resulting in additional expenditure of Rs.48.93 crore.

(Paragraph 2.1.9)

Though proposals for outsourcing of OB removal for next year were to be received six months in advance there were delays in submitting the proposals by OC mines authorities. Two proposals received for outsourcing of OB removal relating to the same mine were finalized separately at different rates resulting in extra expenditure of Rs.19.47 crore.

(Paragraph 2.1.13)

The Company incurred avoidable expenditure of Rs.8.55 crore in drilling and blasting of top soil/loose soil due to award of contracts at composite rates without segregating the quantities of topsoil that did not require drilling and blasting.

(Paragraphs 2.1.14 and 2.1.15)

After imposition of service tax, the company accepted the rates of diesel component quoted by the contractors without verification, resulting in extra commitment of Rs.43.13 crore. Delay in bifurcation of contracts also resulted in additional burden of Rs.9.78 crore.

(Paragraph 2.1.18)

The Company did not levy penalties for short excavation in lower benches in spite of provisions contained in the contracts and subsequently incurred Rs.7.96 crore for removal of left over quantities

(Paragraph 2.1.23)

For the purpose of bifurcation of ongoing contracts, the company accepted different rates for cost of explosives for two contracts in the same mine resulting in extra expenditure of Rs.1.50 crore

(Paragraph 2.1.27)

Introduction

2.1.1 Coal is mined mainly through two methods viz., Open Cast (OC) mining and underground mining depending upon the geological nature of coal deposits. Coal production from OC mines contributes 62 *per cent* of the total coal production of the company. The first opencast project in the company was started at Ramagundam during 1974. There were 14[*] working OC mines and three closed mines as on 31 March 2006. Feasibility Reports (FRs) of OC mines indicate the quantum of Over Burden[†] (OB) to be removed and mineable coal i.e., Stripping Ratio[‡]. The company carried out the removal of OB till 1991 with its Heavy Earth Moving Machinery (HEMM) after which outsourcing of OB removal work was introduced to clear the backlog of OB. The quantity of OB to be removed by the Company or through outsourcing was being indicated in the FRs of mines. The expenditure towards OB removal for the last five years ended 31 March 2006 ranged between 23 to 25 *per cent* of the total expenditure of the company.

The management of the Company is vested in a Board of Directors consisting of 10 Directors including the Chairman & Managing Director (C&MD) who is the Chief Executive of the Company. The Company has its Corporate Office at Kothagudem and 12 administrative coal producing areas. Each administrative area is headed by a General Manager (GM) and each mine is headed by a Mine Manager.

Scope of audit

2.1.2 The performance review of OB removal operations covering the last five years ended 31 March 2006 was conducted in respect of 11 out of 14 working and three closed mines. All the 26 contracts each involving more than Rs.10 crore entered into for removal of OB through outsourcing during the five years ended 2005-06 were examined in audit.

Audit objectives

2.1.3 The performance review of OB removal in OC mines of the Company was conducted with a view to ascertain whether:

- procedures and provisions laid down in various statutes / manuals concerned with OB were complied with;
- activities performed by the contract management cell were in tandem with the intended objectives;

[*] Working mines: GK OC, JVR OC I, KOYOC, YOC I, YOC II, MNG COC, MNG OC II, MNGOC III, MNG OC IV, Meadpalli OC, RG OCI, RG OCII, RG OC III, Khairagura OC. Closed mines :BPA OC II, YOC C & YOC D.

[†] Soil / rocky earth above the coal seams.

[‡] Ratio between minable coal and OB to be removed

- execution of OB removal work was as per the terms and conditions of the work orders;
- OB removal in OC mines was done economically, efficiently and effectively; and
- the internal control mechanism was effective.

Audit criteria

2.1.4 The following audit criteria were adopted:

- Projections made in the Feasibility Reports;
- Policy of the Government of India on mining operations;
- Relevant provisions in the Statutes and Manuals including OB Survey Manual;
- Estimates and offloading proposals prepared and work orders issued by the Company; and
- Requirements laid down in the Environment Management Plans.

Audit methodology

2.1.5 The methodology adopted for attaining the audit objectives with reference to the audit criteria were examination of:

- outsourcing proposals initiated by mine authorities and files relating to awarding of contracts;
- records relating to execution of contracts i.e., Measurement Books (MBs), store records, etc.;
- records maintained in blasting section etc.,
- check survey records; and
- issue of audit observations and interaction with the management.

Audit findings

2.1.6 Audit findings arising from the performance review were reported to the company and State Government in September 2006 and discussed in the meeting of the Audit Review Committee for State Public Sector Enterprises

(ARCPSE) held on 28 September 2006 which was attended by the Joint Secretary, Energy Department, Government of Andhra Pradesh and Chairman and Managing Director of the Company. The views expressed by the members have been taken into consideration while finalizing the review.

Audit findings are discussed in the succeeding paragraphs.

Overburden removal by the company and through outsourcing

2.1.7 There were 14 working OC mines as on 31 March 2006. During the five years ended 31 March 2006, the company opened four new mines and closed three existing mines. The table below indicates the number of mines in which OB removal operations were carried out either by the Company or through outsourcing or by both during the last five years ended 31 March 2006.

Year	OB removal			Total
	By company	By out-sourcing	By both	
2001-02	3	1	9	13
2002-03	5	2	7	14
2003-04	6	2	6	14
2004-05	4	2	5	11
2005-06	4	5	5	14

The details of OB removed by the Company itself and through outsourcing in the last five years ended 31 March 2006 were as under:

Year	(Quantity of OB removed in lakh bank cubic meters (lbcm)[§]	
	By company	Through out-sourcing
2001-02	486.61 (52)	443.32 (48)
2002-03	526.34 (52)	491.90 (48)
2003-04	538.97 (62)	335.18 (38)
2004-05	570.93 (56)	447.65 (44)
2005-06	567.51 (49)	589.51 (51)
Total	**2690.36**	**2307.56**

(Figures in brackets indicate percentages)

[§] bank cubic metre (bcm) means one cubic metre of OB excavated transported and dumped in the earmarked dump yard. OB is measured in lakh bank cubic metres (lbcm)

The Company prepares Feasibility Reports of each mine indicating the quantity of OB to be removed either by the Company itself or through outsourcing. The Feasibility Reports are put up to the Board along with the suggestions/recommendations of the Standing Technical Committee (STC)[**] of the company on cost estimates and other technical items of respective mines. Audit scrutiny revealed that:

- while submitting Revised Cost Estimates (RCE) of Jalagam Vengala Rao (JVR) OC, the STC of the company recommended (19 October 2004) that the company should not give up its core competence in OB removal and carry out at least 30 *per cent* of OB removal work with its men and machinery so as not to keep them idle. The Board initially accepted (20 October 2004) the observation, but subsequently, deviating from its own decision, approved (28 December 2004) 100 *per cent* outsourcing of OB removal in JVR OC mine.

There is no clear cut stated policy for outsourcing of OB removal

- the company did not have any clear-cut stated policy on outsourcing of OB removal from the beginning. The ratio of OB removal through outsourcing *vis-à-vis* company's own machinery was recommended by STC (October 2004) as 70:30.

- though the company has been carrying out more than 30 *per cent* of OB removal work through its own machinery, there were huge minewise variations.

The yearwise details of number of mines where outsourcing of OB removal was more than 70 *per cent* as well as *100 per cent* were as under.

Year	Number of mines where outsourcing was more than 70 *per cent* but less than 100 *per cent*	Number of mines where out-sourcing was 100 *per cent*	Total number of mines where outsourcing was more than 70 *per cent*
2001-02	4	1	5
2002-03	5	2	7
2003-04	4	2	6
2004-05	3	2	5
2005-06	6	5	11

More than 70 percent of OB removal was outsourced in five to eleven mines in each year

It would be observed from the above table that in respect of five to eleven mines in each year, the company outsourced more than 70 *per cent* of OB removal work in the last five years ended 31 March 2006.

The Management stated (October 2006) that based on the verbal information about Government of India's policy given by the then Project Advisor, Ministry of Coal (MoC), who was one of the Directors on the Board of the

[**] Standing Technical Committee (STC) is a sub committee of the Board which gives suggestions/recommendations on technical matters before submission to the Board.

Company, Revised Cost Estimates (RCE) for JVR OC for 100 *per cent* outsourcing were approved by the Board of Directors. It was further stated that percentage of outsourcing has to be considered on overall basis for the company as a whole. The reply is not tenable as in the absence of any formal background paper or copy of the Government of India's policy and also in view of huge costs involved in shifting HEMM, minewise norms for outsourcing or otherwise should have been fixed.

Targets and achievements

2.1.8 The Project Planning Department of the company fixes yearwise and minewise targets for OB removal corresponding to targets set for coal production in five year plan. Minewise, yearwise targets and achievements of OB removal for the five years ended 2005-06 are given in the **Annexure - 9**

It would be observed from the annexure that the projections in the FR for OB removal were not taken into account while fixing the yearwise targets for the respective mines. In most of the cases the targets were fixed far in excess of projections envisaged in FRs of the respective mines. Thus the targets fixed were unrealistic.

FR projections of OB removal were not taken into account while fixing the minewise targets

The Management stated (October 2006) that almost all the OC mines were overexploited beyond their annual targets envisaged in the FRs due to huge gap between demand and supply of coal. The reply is not tenable as the company should have fixed targets on a realistic basis and keeping in view the designed capacities of HEMM.

Stripping ratio of coal vs OB

2.1.9 Stripping Ratio represents the ratio between the mineable reserves of coal and OB to be removed. The stripping ratios of various OC mines of the Company ranged between 1:3.36 and 1:6.19. The quantity of OB to be removed depends upon the stripping ratio which was based on the geological report. These stripping ratios are envisaged in FRs of each mine. There was backlog of 508.22 lbcm of OB removal in seven mines as on 31 March 2004. During the year 2004-05 the Company reviewed the backlog / advance[††] action in OB removal and revised the stripping ratios of 12 mines mainly on the plea that there was change in mineable reserves and geological reports were not correct.

Audit scrutiny revealed that:

- no prior approval of the Board of Directors was obtained for revision of the stripping ratios;

[††] Backlog means if OB was removed less than the quantity according to stripping ratio. where as advance action means removal of OB more than the stripping ratio.

- the company did not conduct any systematic and scientific study for arriving at the mineable reserves resulting in revision of stripping ratios; and
- the details of computation of revised mineable reserves were not on record.

Backlog of OB removal in six OC mines resulted in additional expenditure of Rs.48.93 crore

It was noticed in audit that as on 31 March 2006 there was backlog of OB removal in six OC mines[♣]. Out of six mines three mines (MNG OC II, RG OC III, and Koyagudem) were in backlog continuously for the last five years. The company was not able to take care of the backlog despite continuous outsourcing which resulted in additional burden of Rs.48.93 crore representing the difference between the cost of OB removal for the year 2005-06 and the cost in the previous year.

The Management stated (October 2006) that the Board approval was obtained for change in accounting policy in respect of accounting of OB removal duly appraising the necessity for revision and its financial impact at the time of approval of annual accounts. It was further stated that the backlog was due to increase in coal production and also decrease in outsourcing of OB removal, conversion of underground mines into OC mines and non availability of OB due to unforeseen geological reasons, etc.

The reply is not tenable as the impact of revision of stripping ratios is a deviation from the approved FRs, and therefore, prior approval for revision should have been obtained. Inspite of outsourcing and revision of stripping ratio there was backlog in six OC mines as on 31 March 2006 which was not taken care of by the company resulting in additional expenditure.

Contract Management Cell (CMC)

2.1.10 To streamline the activities pertaining to OB removal, the Company established (December 1999) a Contract Management Cell (CMC) with the following objectives.

- Preparation of OB removal manual.
- Maintaining a database of men and machinery available with each contractor, contracts awarded, outsourcing proposals received from mines, rates quoted in various tenders by contractors, performance of each contractor, similar works done by individual contractors, etc.
- Processing and submitting proposals for awarding the work of OB removal to the competent contractors through the Tender Committee and monitoring its implementation.

The following points were noticed in audit:

[♣] GK OC, YOC II, KOY OC, MNG OC II, RG OC III & Medapalli OC

- Draft OB removal manual was still (July 2006) to be submitted to the Board, in the absence of which the provisions contained in the Purchase Manual were being followed.

- No database /track record of OB removal contractors was being maintained.

- Though OB removal work was to be executed by the selected tenderer without sub-contracting, there was no mechanism with the CMC to check the same. It was noticed that the OB removal work was sub-contracted in two cases.

- As per the existing practice, quotations were obtained for bench-wise quantities i.e., for each 10 metres Reduced Levels (RL), alongwith the weighted average rates for the proposed quantities. The Board directed the CMC (September 2001) to simplify the procedure. The CMC suggested (February 2002) that calling for uniform rate for the entire work was not advantageous. This suggestion was, however, not supported by any reason. The company amended (February 2006) the tender clauses in Notice Inviting Tender (NIT) and modified levels from 10 Mtrs to 30 Mtrs without taking into consideration the advantages / disadvantages of calling quotations for 30 Mtrs RLs.

The Management, while accepting all the above observations, assured (October 2006) that it would take action regarding database management and review the issue of sub-contracting.

Vendor Development

2.1.11 Annexure 10 contains the details of orders placed, name of the contractor / firm and value of contracts during the last five years ended March 2006. It was observed in audit that a few vendors had monopolised the work of outsourcing and the company had not taken any steps for vendor development. Audit scrutiny revealed the following :

Few contractors have monopolized the works

- During the last five years ended 31 March 2006, five contractors /firms were awarded more than one contract for OB removal in different mines during the same period/simultaneously. The company awarded during this period, six contracts to ABC Engg Works and four contracts each to Sri V Prabhakar Reddy and Sri B Girijapathi Reddy, three contracts each to EPIL and Sri P Laxmu Reddy involving a total quantity of 2888.77 lbcm of OB to be removed.

- The same parties were quoting lower rates in subsequent tenders despite increase in cost of various inputs. Out of six tenders floated for OB removal in five mines during 2004-05 (finalised in 2005-06) , B Girijapathi Reddy quoted Rs.41.38/bcm (L3) in 2001-02 and Rs 36.08 / bcm (L1) in 2005-06 in respect of Medapalli Opencast Project; V Prabhakar Reddy quoted Rs 38.72 / bcm (L5) in 2003-04 and Rs

25.80 / bcm in 2005-06 (L1) in the Koyagudem OC; S V Engineering works quoted Rs 43.48/bcm (L1) in 2003-04 and Rs 39.22/bcm (L1) in 2005-06 for OB removal work in Ramagundam OC III mine.

- Similarly ABC Engg Works quoted a price of Rs 37.80 / bcm for OB removal work in Bellampalli OC II in 2000-01 and Rs 35.28 / bcm for OB removal works in the same mine in 2001-02. P Laxmu Reddy, quoted Rs 40.47 / bcm (L1) for OB removal work in Manuguru OC IV in 2001-02 and quoted Rs 40.49 / bcm (L1) for OB removal work in the same area (i.e., Manuguru OC IV) in 2003-04. In spite of three years gap between the two work orders, the contractor (Gulf Oil Corporation) quoted Rs 33.24 / bcm for OB removal work in Koyagudem OC in 2003-04 as against Rs 34.79 quoted for OB removal work in the same mine in 2000-01.

The fleet of HEMM in the possession of the contractor was not verified before awarding contract

- As per Notice Inviting Tender (NIT) for the work of excavation of 78.84 lbcm of OB, the contractor was required to possess the minimum HEMM 10 numbers of 3.5 cum. shovel and 60 numbers of 16 cum. dumpers. It was noticed that the company was not verifying the possession of prescribed minimum equipment by the contractor at any time. One contractor viz., ABC Engg Works which was awarded six contracts simultaneously for removal of 1038.42 lbcm, should have possessed minimum of 92 nos, of 3.5 cum shovel and 592 nos of 16 cum dumpers which entails a huge fleet. The company, however, did not verify at any time whether the contractors were in possession of such a huge fleet of HEMM for executing the works.

The Management stated (October 2006) that the number of HEMM indicated in the NIT / Order is only an indication and the criteria of performance is the volume of work carried out against the given schedule. The reply is not tenable, as the cost per bcm is worked out on the basis of number of HEMM to be deployed. The Management, however, did not give any specific reply about monopoly of the activity by a few contractors.

Insufficient Earnest Money Deposits (EMDs)

EMD was collected in the form of FDR instead of DD

2.1.12 The Purchase Manual prescribes that an amount of Rs.50 lakh towards permanent Earnest Money Deposit (EMD) in the form of DD drawn in favour of the company is to be given by each tenderer for participating in any number of OB excavation tenders. The Company, however, accepts EMD in the form of Fixed Deposit Receipts (FDRs) in the name of the company but on contractor's account.

Audit scrutiny revealed the following:

- Efforts were not made to get the FDRs renewed after expiry of their term in five cases out of nine cases test checked.

- Contrary to the provisions of the Purchase Manual, the company returned FDRs to two contractors during the period April 2004 / May

2005 on the representation of the contractors that they would furnish fresh EMD as and when they participate in the OBR tenders.

- Though the Company obtained Rs.50 lakh each as EMD from four contractors who were individually awarded work valuing more than Rs.100 crore, this amount was not adequate for levying penalty against non-execution of even one month's scheduled work. In one case, it was noticed that out of three work orders issued to Engineering Projects India Limited (EPIL), one work was terminated due to poor performance and awarded to another contractor viz. ABC Engg works (a contractor to whom five orders had already been given) at higher rates. The company could not recover penalties to the extent of Rs.27.88 crore from EPIL. The matter was subjudice (October 2006).

The Management stated (October 2006) that:

- even if the FDRs are not renewed as long as they are pledged with the company the purpose of security will be served;

- in case any tenderer wishes to withdraw permanent EMD, after withdrawal of the same he will not be allowed to deposit permanent EMD again for a period of two years. However, he can participate in the future tenders within two years by paying normal EMD for each work;

- for those who submitted permanent EMD further security deposit of one *per cent* of the bill was being deducted from their bills which is returned at the end of the contract.

The reply is not tenable as

- the permanent EMD is to be obtained in the form of DD only as per the Purchase Manual;

- refund of permanent EMD and allowing the contractor to participate in future tenders on payment of normal EMD for each work defeats the purpose of obtaining permanent EMD;

- further security deposit (FSD) of one *per cent* of the bill arises only when the work is in progress. If the contractor abandons the work (particularly in cases where one contractor is awarded number of works) leaving huge quantity of OB unexcavated, the permanent EMD of Rs.50 lakh would not be adequate to recover the penalty.

Execution of OB removal contracts

The award of overburden removal contracts and their execution was examined in audit and the irregularities noticed are discussed in the succeeding paragraphs;

Delay in finalisation and placement of outsourcing contracts

2.1.13 As per OB survey manual, proposals were to be received six months in advance of the next financial year so that work orders are finalised and placed by the end of the current financial year. The details of date of proposal for outsourcing, date of awarding the contract, etc., in respect of 26 contracts finalised during the last five years ended 31 March 2006 are given in **Annexure 11**.

Audit scrutiny revealed the following;

- The time taken from the date of receipt of the proposal to the placement of work order ranged beyond six months in 15 out of 26 cases.

Two proposals for outsourcing in the same mine finalized separately resulted in extra expenditure of Rs.19.47crore

- Two proposals for outsourcing of OB removal with similar parameters were received from MNG OC IV mine in July 2003 (for 200 lbcm) and February 2004 (for 118.80 lbcm). The proposal received in February 2004 was finalised and work order issued in September 2004 at Rs 56.88 per bcm and for the proposal received in July 2003, work order was issued in March 2004 at Rs 40.49 per bcm. Had these two proposals for outsourcing for the year 2004-05 been received well in advance of the financial year and been finalized simultaneously the company could have avoided extra expenditure of Rs.19.47 crore at Rs 16.39/bcm (Rs.56.88 – Rs.40.49).

The Management stated (October 2006) that delay in processing some proposals occurred mainly for bringing modifications in the scope of work and terms and conditions based on previous experience. It was further stated that it was not possible to initiate proposals for all the requirements at the same time. The reply is not tenable as before the placement of order, both the proposals were under process and could have been finalised simultaneously at the lower cost.

Quantity of Top soil was not indicated in NIT / order though it did not require drilling and blasting

Excess expenditure on excavation of top soil

2.1.14 FRs of OC mines are approved subject to compliance of the provisions in the Environment Management Plan (EMP). One of the provisions stipulated in the EMP is that the top soil /sub soil excavated should be dumped separately to be reclaimed at the time of closure of the mine for off-setting the land degradation caused. The topsoil should be removed only by scrapper / excavator, without being blasted so that it retains nutrients / bacteria, which help in regeneration of plant life. The OB removal contracts did not contain specific clauses for the above requirements. As the top soil / sub soil is required to be excavated without drilling and blasting it should be treated as a separate item in contracts awarded for drilling, blasting and excavation of OB.

Audit scrutiny revealed the following:

- Contracts were awarded for blast hole drilling, blasting and excavation work at a composite rate, without specifying the quantity of top soil that did not require blast hole drilling and blasting.

- Though bench-wise weighted average rates of 10 meters Reduced Levels (RL)[‡‡] each excluding the top layer are being called for and the approximate height and quantity of OB against the top layer were also being given for the purpose of quotations, the tenderers in practice were quoting the bench-wise rates starting from the top layer with progressive increase by few paise per bcm.

Non-segregation of top soil for drilling and blasting purposes resulted in avoidable expenditure of Rs.6.61 crore

- Awarding the contracts on a composite rate without segregating the quantity of top soil resulted in an avoidable expenditure of Rs 6.61 crore in respect of 17 orders in 10 mines executed during the last five years ended 31 March 2006 towards drilling and blasting of excavation of top soil.

- The top soil removed was not being certified for quantity by any authority / official before the bill was cleared for payment.

The Management stated (October2006) that approximate top soil quantity estimated by the company was being indicated in the NIT and it was not practicable to assess the extent to which the top soil can be excavated to a particular level at all places. The reply is not tenable as the top soil does not require drilling and blasting. As such calling for quotations uniformly for all the benches without any segregation for awarding contracts at weighted average rate lacks justification. Mere indication of top soil quantity in the NIT does not serve any purpose.

Quantity of loose soil was not indicated in the NIT / order though it did not require drilling and blasting resulting in avoidable expenditure of Rs.1.94 crore

Avoidable expenditure on removal of loose soil

2.1.15 The Company proposed (January 2001) outsourcing of 139.4 lbcm of OB removal at Medapalli OC for meeting the targets of coal production for the years 2001-02 and 2002-03. The proposal included removal of 30.4 lbcm (2.4 lbcm from temporary bund and another 28 lbcm of loose soil) which did not require drilling or blasting. Tenders were invited (April 2001) for the blast hole drilling, blasting, excavation, loading, transportation, dumping etc., and orders were placed (August 2001).

Audit scrutiny of the contract revealed the following:

- It was mentioned in the order that only 2.4 lbcm of loose soil (temporary bund) did not require blasting instead of 30.4 lbcm not requiring blasting. The company incurred avoidable expenditure of Rs.

[‡‡] RL –means OB is removed by way of steps with a bench height of 10 Mtr for moving HEMM

1.94 crore towards drilling (Rs 2.65 lakh) and blasting (Rs 1.91 crore) for 28 lbcm of loose soil.

- The contractor had not excavated 2.51 lakh lbcm in lower bench covered under the scope of the work order. This left over OB work was subsequently included in the scope of a different work order with the same contractor to be paid at higher rates. Payments for the left over works at higher rates awarded to the same contractor under a separate work order resulted in additional expenditure of Rs 29.31 lakh to the company.

The Management stated (October 2006) that it was clearly mentioned in the NIT that out of 139.40 lbcm quantity, blasting was required for approximate quantity of 109 lbcm and that the contractor excavated more than 100 *per cent*. The agency had completed the contract period and the area was awarded in the next contract as per tender procedure. The reply is not correct as the quantity of loose soil was not mentioned in the order and the contractor followed the terms and conditions of the work order only.

Delay in handing over of site and consequential changes of dumping locations

2.1.16 OB removal work at Koyagudem OC mine for 120.90 lbcm (Central Pit 118.65 lbcm, Western Pit 2.25 lbcm) was awarded to Gulf Oil Corporation Limited (GOCL) at a weighted average rate of Rs 33.24 per bcm. The quantity awarded was further increased by 1.84 lbcm due to addition of one more bench in the western pit.

Audit analysis of this contract revealed the following:

- There was a delay of five months in commencing the work (June 2004) from the date of award of contract (January 2004) due to delay in finalisation of final level survey of earlier order by the company**.**

Delay in handing over of site resulted in additional expenditure of Rs.27.06 lakh

- In western pit, it was proposed to use the OB for back filling. As there was delay in handing over the site by the company, the agency dumped the OB at a different dump yard instead of back filling resulting in increase in lead to 1.796 km as against the awarded lead of 1.013 Kms. This resulted in additional expenditure of Rs 27.06 lakh due to increase in lead by more than 10 *per cent* and reworking of weighted average rate per bcm as per the terms of the contract.

- Though the contract was awarded at uniform weighted average rate per bcm both for central pit and western pit, operated lead distance was calculated for western pit and extra payment was made accordingly**.** Weighted average rate per bcm was not reworked out inspite of reduction in lead distance in central pit due to short excavation of 26 *per cent* of ordered quantity.

The Management stated (October 2006) that the lead variation in central pit was within permissible limits not exceeding 250 Metres and that penalty was not imposed as the contractor had excavated the available quantity. It further stated that payments were made based on pitwise excavated quantities and operated lead. The reply is not tenable as the contract was awarded at uniform weighted average rate though there were two separate dumps with separate lead distances. Further if the ordered quantity of OB was not available for excavation, the mine authorities should have reworked the weighted average rate per bcm considering the variations in lead distances.

Revision of OB removal contracts due to imposition of service tax

2.1.17 The Finance Act 2005 introduced Service Tax (10.2 *per cent*) with effect from 16 June 2005 for all works involving site preparation and clearance, excavation, earth moving and demolition services. The legal department of the Company opined that the service tax could be imposed only on the cost towards services provided excluding the other cost i.e. cost of materials etc. The OB removal contractors represented (April 2005) for reimbursement of service tax which was agreed (December 2005) by the Company after negotiations (September 2005) as follows:

- The company would supply diesel and explosives to the contractors.
- Ongoing contracts would be amended limiting the work to excavation and transportation only. For this, the contractors were asked to furnish the weightage assigned to explosives and diesel so that the same could be reduced from the benchwise rates and rates re-worked.
- Service Tax liability for the intervening period (from the date of imposition of service tax to the date of amendment to the contract i.e. 16 June 2005 to 16 December 2005) for the contracts in hand will be shared by the company and the contractor in the ratio of 90:10 respectively.
- In future, contracts were to be segregated into supply contracts (company supplies diesel and explosives) and excavation contracts (i.e., contracts for hiring of HEMM on weighted average rate).

It was noticed by audit that the contractors furnished the rates of diesel and explosives per bank cubic metre (bcm). The Company amended the contracts and intimated (January 2006) all the contractors accepting the weightage assigned by the contractors to diesel and explosives. The cases of acceptance of different rates offered by the contractors, undue favour, extra expenditure in awarding of contracts, payment/recovery towards bonus/penalty noticed in audit are discussed in the succeeding paragraphs**.**

Acceptance of rates offered by contractors for diesel component without verification.

Rates of diesel component quoted by the contractors were accepted without verification resulting in extra commitment of Rs.43.13 crore.

2.1.18 The Company at the time of finalisation of initial contracts accepted to reckon the cost of diesel at 40 *per cent* of the awarded weighted average rate and any further increase was to be offset by escalation formula. In the amended contracts, the Management, however, accepted the rates / quantity of diesel element stated by the contractors without verifying with reference to the weightage of 40 *per cent* assigned to diesel in the original contract. This resulted in extra commitment to the company to the tune of Rs 43.13[§§] crore on account of diesel component to be supplied by the company in nine ongoing contracts during the tenure of the contract. It was further observed that:

Delay in bifurcation of contracts into supply and execution contracts resulted in additional burden of Rs.9.78 crore on account of service tax

- There would be further extra commitment to the company to the tune of Rs 6.89 crore towards service tax for diesel and explosives for the balance quantities of OB to be excavated.
- Though negotiations with the contractors were initiated in June 2005, the issue was settled by December 2005. In the intervening period, payments were made at the composite rate. Due to delay in bifurcation of the contracts, as supply and execution contracts, the company had to bear service tax on the composite rate, to the tune of Rs 9.78 crore from 16 June 2005 to 15 December 2005.
- No cost benefit analysis was done by the company for hiring of HEMM vis-à-vis awarding of contracts on weighted average rate per bcm excluding diesel and explosives.

The Management stated (October 2006) that the limit of 40 *per cent* of the weighted average rate was for price variation clause (PVC) for drilling and excavation component only and blasting component was not subjected to PVC on diesel. The reply is not correct as the Company was revising the weighted average rate per bcm before introduction of service tax using the formula which indicated 40 *per cent* as the diesel component for all the activities including blasting. As such, instead of calling for prices for diesel for segregation of contracts into material and service portion the segregation should have been straightaway worked out taking 40 *per cent* of weighted average rate as diesel component.

Regarding delay in segregation of contract, the Management stated that since various agencies were involved, it could not be settled till 16 December 2005. The reply is not tenable as the service tax was imposed in June 2005 and, considering the huge expenditure involved, the matter should have been settled on priority.

[§§] The sum of difference between 40 *per cent* of the awarded rate per bcm in each contract which is diesel component minus the accepted price for diesel component in respect of nine ongoing contracts.

Undue favour to contractors

2.1.19 In the case of OB removal work in RG OC III mine, tenders were invited in March 2005. The concept of service tax was not in existence at that time. Due to introduction of service tax from June 2005, negotiations were held (September 2005) with all the contractors for ongoing contracts. SV Engineering Works which was one of the tenderers, was not invited for negotiations. During negotiations with the contractors it was agreed to share service tax in 90:10 proportion. All the technically accepted contractors were requested to submit revised offer, whereby SV Engineering emerged as the lowest (L1). Orders were placed (November 2005) on SV Engineering accepting to reimburse 100 *per cent* service tax, thus involving an additional commitment of Rs.28.60 lakh towards service tax. It was also noticed that service tax was being paid to the contractor as a part of bill without verifying whether the contractor had actually paid the service tax instead of as reimbursement on production of proof of payment of service tax by the contractor.

The Management stated (October 2006) that as the order was placed on SV Engineering works after introduction of Service Tax (ST), no negotiations were held with them for sharing of ST. The reply is not tenable, as the process of outsourcing of OB removal work in RG OC III mine having started in March 2005, SV Engineering also should have been invited for negotiations for sharing of ST liability in 90:10 proportion on par with ongoing contracts.

2.1.20 Similarly, the Company awarded (January 2006) the work for removal of 183.20 lbcm of Overburden at Koyagudem Opencast mine to V Prabhakar Reddy, wherein the company allowed 100 *per cent* reimbursement of service tax instead of 90:10 proportion as allowed in all other contracts resulting in extra commitment of Rs 43.75 lakh on account of service tax (10.2 *per cent* service tax on Rs 437.49 lakh).

Extra expenditure in the award of contract

2.1.21 Tenders were invited (March 2005) for removal of 78.84 lbcm of OB at RG OC III Project for drilling, blasting and excavation as a composite activity. As per quotations received and opened in May 2005 Sri B Girijapathi Reddy emerged as the lowest (L1) tenderer at a weighted average rate of Rs 58.85 per bcm.

Due to imposition of service tax from June 2005, negotiations were held with the tenderer, who informed (June 2005) that the contract was acceptable in case service tax at 10.2 *per cent* was leviable only on service / manpower portion (excluding diesel and explosives).

The offer was rejected and the matter was placed (August 2005) before the Board. The Board suggested to go for retendering and also advised that the Company should mobilise resources to carry out OB removal departmentally. In the meanwhile, the Board also directed that revised price bids were to be obtained from all the technically qualified bidders (who quoted in response to earlier tender) taking away diesel and explosives from the purview of the contractor for the purpose of service tax. It was observed that the same conditions were proposed by the L1 tenderer (Sri. B.Girijapathi Reddy) during negotiations in June 2005.

Extra expenditure of Rs.4.04 crore due to non acceptance of offer proposed by L1

In response only 3 firms viz., B.G.Reddy, S V Engg Works and V Prabhakar Reddy responded (October 2005). SV Engineering Works, (originally 2nd lowest tenderer in the first instance) emerged as L1 and got the contract at the revised weighted average rate of Rs 39.22 per bcm excluding cost of diesel and explosives. The cost per bcm worked out to Rs 69.99 after including the cost of diesel and explosives. It was observed in audit that the company could have saved Rs.4.04 crore[♦] by accepting the initial proposal of Sri B. Girijapathi Reddy made in June 2005.

The Management stated (October 2006) that keeping in view the existing boom for the excavation equipment the negotiated rates were reasonable but since the tender was only in the processing stage, awarding of contract based on the outcome of a future happening was not possible and not legally comfortable. The reply is not tenable as it was not based on any legal opinion or on facts. Further B. Girijapathi Reddy was one among the technically qualified bidders from whom revised bids were called for. Thus, by not considering the original proposal of B Girijapathi Reddy, the Company incurred avoidable expenditure of Rs.4.04 crore on the work.

Payment of bonus / Recovery towards less/excess consumption of diesel

2.1.22 In terms of agreement (7 December 2005) with the contractors, the on-going contracts were modified (16 December 2005) and the company decided to supply diesel and explosives at the specified rates per bcm. The following clauses were incorporated in the modified orders towards recovery for excess consumption or bonus for short consumption of diesel:-

- For value of quantity of diesel consumed by the contractor over and above the value arrived as per agreed rates per bcm and the quantity excavated, a penalty equivalent to the value of excess consumed diesel would be levied on the contractor and the same would be recovered from the work done bills of the contractor on monthly basis.

- In case the value of diesel consumed by the contractor is less than the value arrived as per agreed rates of diesel per bcm and the quantity excavated, an amount equivalent to the value of diesel saved during the month would be paid to the contractor as bonus.

- The price on account of diesel escalation shall be computed for monthly surveyed quantities based on the specified formula for the benchwise rates as per the original order. The amount of diesel escalation for the month shall be added to the value of diesel

[♦] 78.84 lbcm *(69.99 (-) 58.85 +ST)

computed at the agreed diesel rate per bcm of the amended order. The total value of diesel computed as above shall be accounted against the supplies of diesel made by the company for the purpose of the above two clauses.

Audit scrutiny revealed the following:

- As diesel was excluded from the purview of the contractor, price variation clause should have been deleted from the modified order. A test check of such payments in three ongoing contracts in Manuguru area for the month of June 2006 revealed that the Company incurred additional expenditure of Rs.14.45 lakh which will have a recurring effect. The total additional expenditure is not quantifiable due to the complex calculations involved bench-wise, mine-wise and month-wise.

Contract price was enhanced with retail diesel prices whereas penalty for excess consumption was recovered at bulk procurement price.

- While payments towards escalation on account of diesel price increase was being made at the IOC notified prices (retail price at the respective area local petrol bunk), recovery towards excess consumption was being effected at bulk procurement price. Since the retail rates at the bunk would always be higher than the bulk procurement price, recovery at bulk price would result in additional expenditure to the Company and would be an undue favour to the contractors. A test check of recovery towards excess consumption of diesel in respect of order number KOC 62 revealed that during the period 16 December 2005 to 30 June 2006 recovery towards excess consumption was made at procurement price of Rs.32.71 per litre, but value of price variation per bcm of OB excavated on account of diesel price increase was paid at Rs.33.85 per litre, thus resulting in additional expenditure of Rs.36.31 lakh.

- As regards bonus due to saving in consumption of diesel, no restriction of a maximum was indicated. Consumption of diesel would be less in upper benches and the contractor would get higher bonus, but in lower benches there would be recovery due to higher consumption. If the contractor does not excavate the required quantity in lower benches, the bonus payment made in the upper benches would be to the advantage of the contractor.

The Management did not offer any specific comment to the above audit observations.

Non levy of penalty for short excavation in lower benches

2.1.23 As on 31 March 2006 out of 26 contracts awarded, 14 contracts have been completed. On completion of the work the project officials prepare the Work Completion Reports (WCR) indicating the quantities awarded, quantities actually excavated, bench-wise variance, variation in lead distance, if any, and variations in quantities between final survey report prepared by the final survey team and quantities arrived at by the mine authorities etc. It would also indicate the reasons for shortfall in bench-wise quantities.

Penalty for short excavation in lower benches was not levied

Audit scrutiny of the work completion reports (WCR) of completed contracts revealed that in almost all the cases, where the bench-wise quantities, particularly in lower benches, were not fully excavated the company indicated reasons like non-availability of OB, geological disturbances or even if the quantities were not excavated, there was no loss of production of coal. The performance of the agencies was thus treated as satisfactory and no penalty for short excavation was levied on the contractors. Short excavation in lower benches ranged from seven to 100 *per cent*

Company incurred Rs.7.96 crore for removal of left over quantities by contractors

It was further noticed that the work regarding removal of left over OB quantities in the lower benches was awarded to another contractor along with OB from other areas in five cases and excavated by the company with its own equipments in two cases. This resulted in extra expenditure to the tune of Rs.7.96 crore (worked out at the differential cost between the present contract and the next awarded contract). Though the agreement provided for recovery of penalties in such cases, no action was, however, taken in any of the above cases to levy penalties.

The Management stated (October 2006) that:

- it becomes inevitable some time to take-over certain OB benches in patches for removal of OB immediately overlying coal seams by the Company's equipment by diverting them from their identified place of excavation work to increase the coal exposure/production;

- for the working conditions which are quite unpredictable; the outsourcing agency cannot be penalized;

- the question of awarding the leftover quantities to another contractor/done by company will depend on the circumstances of individual contract.

The reply is not tenable as the work is awarded at a weighted average rate per bcm for a specified quantity of overburden to be removed. While the OB removal was outsourced, removal of OB by company's HEMM or awarding of left over quantities to another contractor lacks justification. The company should either levy penalties for short excavation as per terms of the contract or recover the cost incurred by the company for removal of leftover quantity from the concerned contractors.

Wrong booking of expenditure towards OB removal

Wrong booking of expenditure of Rs.50.29 crore on OB removal in spite of 100 *per cent* outsourcing

2.1.24 As per FRs of Medapalli (1996-97) and Koyagudem (2002-03) OC mines, OB removal was to be done 100 *per cent* through outsourcing up to 2006-07 and the company's HEMM capacity in the mines was to be fully utilized for coal extraction only. As such, there was no provision for manpower for OB removal in the FR of these mines.

Audit scrutiny revealed that the company had booked Rs.43.55 crore towards cost of OB removal of 12.45 lbcm during the four years from 2002-03 to

2005-06 in respect of Medapalli OC mine and Rs.6.74 crore (which included cost of store of Rs.1.04 crore) towards wages in respect of Koyagudem mine for the last four years. It was also noticed that the coal exposed / excavated corresponding to removal of 12.45 lbcm of OB in Medapalli was nil and no OB was removed in Koyagudem OC mine but expenditure was booked.

Thus, despite 100 *per cent* outsourcing, the company wrongly booked expenditure of Rs.50.29 crore (including wages and power Rs.11.23 crore and stores Rs.1.04 crore) towards OB removal by the Company in respect of Medapalli and Koyagudem OC mines.

The Management stated (October 2006) that the expenditure was charged on the basis of composite activity. The reply is not relevant to the audit observation.

Consumption of explosives

2.1.25 Though the company had been doing its operations in OC mining for the last 30 years it has not fixed norms for consumption of explosives per bcm of OB removed either minewise, yearwise or areawise.

In the initial years of outsourcing of OB removal works, the company carried out blasting operations which includes supply / procurement of explosives. Simultaneously the Company was also carrying out OB removal operation with its machinery in some mines which also involves blasting. The outsourcing work consisted of drilling, excavation, transportation and dumping of OB. The company decided (August 2001) to award composite contracts wherein the agency had to carry out drilling, blasting, excavation and transportation works. Blasting operations are, however, carried out under the supervision of the officials of the company.

Audit scrutiny of consumption of explosives per bcm in respect of OB removal operations by the company and by outsourcing in respect of Ramagundam OC II & OC III revealed that the consumption of explosives per bcm in respect of outsourced contracts ranged between 0.343 Kg and 0.389 kg, but the consumption in respect of OB removed by the company with its equipment ranged between 0.456 kg and 0.696 kg. The company had not analysed the reasons for excess consumption.

The Management stated (October 2006) that technology in OB removal by the company was different from the technology used by outsourced agency, as such consumption of explosives is not comparable. The reply is not tenable as in pit crushing technology for OB removal by the Company, the consumption of explosives is not affected as crushing of OB for transportation through conveyor belt does not require blasting.

2.1.26 Audit scrutiny of contracts bifurcated after imposition of service tax further revealed the following:

- Different parameters were followed in the supply of explosives to the contractor. In respect of three contracts, the company agreed to supply explosives in terms of physical parameters (viz., to supply 0.380 kgs per bcm) and in respect of nine contracts in terms of monetary parameter (viz explosives worth Rs 2 per bcm) as requested by the contractors concerned. No effort was made to verify whether the parameters quoted by the contractors were realistic.

Non incorporation of clause for no-bonus for short consumption of diesel resulted in avoidable expenditure of Rs.1.84 crore

- In the work order No.ROC 3125 dated 30 November 2005 placed on a contractor at Ramagundam OC III Project, in case the contractor consumed lesser quantity of explosives and diesel than agreed, the contractor was not entitled for any incentive as per the agreement. This provision was, however, not incorporated in the agreement (YOC 45) entered into subsequently in January 2006 after introduction of service tax. Thus due to irregular payment terms regarding payment of bonus in the agreement entered into after introduction of ST, the company had to incur an additional expenditure of Rs.1.84 crore to end of May 2006.

- Though there was no consumption of explosives in the top bench at Koyagudem OC mine as no blasting operation was required, the same was treated as savings in consumption of explosives and an amount of Rs 35.48 lakh representing the value of explosives was paid as bonus which lacked justification.

The Management while accepting the audit observations, stated (October 2006) that if bonus was not paid, the contractor would have inflated the benchwise rates to compensate the bonus amount. It further stated that the possibility of excluding the quantity of OB in top bench for the purpose of explosives would be examined and suitable modifications, if required, would be included in the future contracts.

Acceptance of different rates for cost of explosives for two contracts

Acceptance of different rates for cost of explosives for two contracts in the same mine, resulted in extra expenditure of Rs.1.50 crore

2.1.27 In the case of Manuguru OC IV mine, two contractors (working in the same mine under two contracts-(MOC 422 & MOC 250) were executing the work of OB removal. Explosives required for blasting were being supplied by the company. It was noticed in audit that for recovery of the cost of explosives, the Company was charging two different rates (i.e., Rs.2 per bcm in MOC 422 mine and Rs.6 per bcm in MOC 250 mine) from the contractors. This resulted in extending undue benefit to the Contractor in MOC 422 mine to the tune of Rs.1.50 crore up to May 2006 in addition to future commitment of Rs. 16.88 lakh for the balance quantity of OB to be removed. (till the end of the contract towards cost of explosives).

The Management stated (October 2006) that the overall contract value does not change. The reply is not tenable as the consumption of explosives per bcm would entirely affect the cost for the purpose of segregation of composite rate into material and service portion.

Internal control

Internal control is a process designed for providing reasonable assurance for efficiency of operations, reliability of financial reporting and compliance with applicable laws and statutes. An efficient internal control mechanism in coal mining activities requires adherence to the norms of drilling meterage and norms for consumption of explosives. It also requires preparation of realistic estimates for comparison of tender evaluation, monitoring of HEMM deployed and operated lead distances. Audit analysis of the internal control procedures relating to mining activities in the company revealed the following deficiencies:

Preparation of unrealistic estimates for comparison of rates for tender evaluation

The estimates prepared by company for comparison of quotations for out-sourcing were not realistic

2.1.28 In order to assess the rates quoted by the tenderers, the CMC informs Industrial Engineering Department (IED) about the quantity of OB proposed to be outsourced, location of the mine, quantities expected at different reduced levels and HEMM configuration proposed by the project authorities. The IED also considers parameters like equipment cost, rate of depreciation, rate of interest, operating time, quantity that could be removed in one operation and arrives at an estimated rate per bcm and intimates to the CMC. The CMC while processing the tenders compares the rates furnished by IED with the rates offered by the tenderers and put up a proposal to the competent authority for consideration and approval. The parameters used by IED were to be reviewed every two years to arrive at a realistic rate which was however, not being done. The last revision was made in 2002.

In this connection, audit analysis revealed that:

- At no point of time, the Management sought for details of workings from the contractors for the rates quoted by them. In the absence of any parameters from the contractors' side, the estimates were purely hypothetical and served no useful purpose.

- IED adopted 12 *per cent* (2003) as the borrowing costs as against the lower rate of 7 *per cent* prevailing at that time.

- Neither CMC, nor the contractor furnished the type, cost, capacity and age of the equipment to IED. Hence the rates worked out by IED and its comparison with the quoted prices for finalisation and awarding of contracts served no purpose.

- Though the proposal for outsourcing indicates the meterage of drilling required for blasting, quarry depth, dump height, final lead distance and quantity of loose soil / top soil, IED while working out the estimated price, did not consider these factors.

- In 20 out of 26 contracts awarded in the last five years, the company's estimated rates were higher than the rates quoted by L1 tenderers, as indicated in **Annexure 11.**

- In the remaining six cases, weighted average rates worked out by IED were found to be less than the weighted average rate quoted by the lowest tenderer. None of the contractors to whom the works were proposed to be awarded, however, accepted to match their rates with the IED rate. The company justified and finalised the orders in these cases on the ground that the rates quoted were reasonable and compared with the rates being accepted by Western Coal Field Limited (WCL) / Coal India Limited (CIL) with out analyzing the reasons for variations. While rates per bcm were different from mine to mine in the Company itself due to different strata conditions and configuration of HEMM, comparison of rates with WCL or CIL and awarding contracts at higher rates was neither justified nor was in the interest of the company.

Drilling meterage norms

No norms were fixed for meterage to be drilled per bcm of OB to be excavated

2.1.29 The proposals submitted by the Project Office contain the details regarding drilling (in terms of meters) to be done. The proposed meterage to be drilled though indicated in the proposal sent by the Project Office was not included either in the NIT or in the agreements in the absence of which the actual meterage drilled against that proposed was not being monitored. It was observed in audit that the company was making payment to the contractors without any reference to the meterage short drilled as compared to the drilling meterage proposed / required. Audit scrutiny of 13 out of 26 contracts awarded during 2001-02 to 2005-06 revealed that the meterage short drilled ranged from 23 (KOC 32) to 70 (BOC 7) *per cent*. In some mines the record of actual meterage drilled was not maintained. In seven cases short meterage drilled resulted in excess payment of Rs.23.97 lakh.

The Company also carries out overburden removal works with its HEMM. It was, however, observed in audit that there was mismatch between the meterage drilled and the OB excavated in various mines. The Company has not fixed any norms for drilling meterage vis-à-vis overburden to be removed.

The Management stated (October 2006) that in outsourcing, the figures in proposal were only tentative and monitoring of meterage of drilling is not warranted as per the terms of the contracts. The reply is not tenable as the variation in actual to proposed drilling ranged from 23 to 70 *per cent*. Non-monitoring of meterage of drilling is not in the interest of the company as the cost of drilling was proportionate to the meterage drilled which would ultimately affect the cost per bcm.

Non monitoring of HEMM deployed

2.1.30 The estimates prepared by IED were primarily based on a particular combination of HEMM configuration (shovel-dumper combination) and number of equipment to be deployed. The project authorities monitored the HEMM deployment till 2002 after which it was discontinued based on the instructions issued by CMC**.** It was noticed in audit that deployment of HEMM by various contractors was not sufficient to meet the targeted excavation. A few such cases are discussed in the succeeding paragraphs:

- Orders were placed on ABC Engineering Works for removal of 273.72 lbcm of OB at Medapalli OC mine, by blast hole drilling, blasting excavation, loading and transportation for a period of 40 months. As against 8 excavators and 55 dumpers to be deployed as per the order, the agency deployed on an average 6 excavators and 36 dumpers during 29 months of the contract period (March 2006). During April 2006 the agency deployed only 4 excavators and 20 dumpers, which were insufficient to meet the targeted excavation.

- In respect of RG OC III project, the actual deployment of HEMM was not monitored on the plea that any short deployment would result in non-achievement of targets inviting penalties. As the deployment of HEMM had a bearing on the cost, instructions for non-monitoring of HEMM was improper.

- In respect of order No. ROC 1013 also, though the agency was to deploy 14 shovels of 0.9 cum. capacity, 94 dumpers of 6 cum capacity, 4 dozers, the actual deployment was 9 shovels, 47 dumpers and 3 dozers. As the economics of the rate offered by the contractor was assessed based on the HEMM proposed to be deployed, any short deployment would vitiate the workings of estimated rate. No record was made available to audit to show as to whether the actual deployment of HEMM was furnished to IED for reworking of the estimated rate and comparison with the awarded weighted average rate.

- In respect of order No.3125 at RG OC III project against HEMM configuration of seven 3.5 cum shovels and 45 dumpers, (16 cum) actual deployment was only two shovels of 3 cum and 32 dumpers (12 cum) in June 2006.

Non-monitoring of operated lead distance

2.1.31 Removal of lesser volumes in lower benches would reduce the quarry depth and has a bearing on the final weighted average lead distance. In terms of clause 5.5.0 of the OB survey manual, in case of dump yard changes, the weighted average lead has to be recalculated. Contractual terms stipulate that lead distance has to be worked out as per given formula where there is change of location of dump yard, but does not speak about the changes in the dump height, fixed lead and quarry depth. As such there is inconsistency to this extent between the terms of contract awarded and provisions in the OB survey manual. The mine authorities are required to monitor the weighted average lead distance and the interval between successive monitoring should not exceed a quarter.

The following points were noticed in this regard:

- Even in cases where major quantity in the lower benches was left unexcavated, the weighted average lead was stated to be within limits. The mine authorities do not record final parameters of dump height, fixed lead and quarry depth for arriving at the final lead though provided in the OB survey manual. The mine authorities are not recording the final parameters in the Measurement Book (MB) for closure of the contract. A mere certificate indicating that there was no change in the dump location was being recorded.

- Weighted average lead distance is not being mentioned in the MBs. The Measurement Book is a replica of Bill. No additional data like HEMM deployed by the executing agency and changes in lead distance, quarry depth etc., was recorded in it. A mere Certificate of quantities of OB removed without any details/results of check survey/final survey was recorded in MB.

Check Survey

2.1.32 The Board of Directors directed (September 1993) that the actual measurement of OB removal had to be test checked by a team from the Corporate Office comprising one executive each from the Survey Department and the Internal Audit Department.

In this connection the following points were noticed in audit:

- According to para 5.9.2 of OB Survey Manual in the case of final survey a team of officers not assigned with any check survey job has to conduct a thorough check of all arithmetic calculations and plotting before volumes are compared. Separate final survey teams were however, not being constituted but the same check survey teams conducted the final surveys also.

- As per para 1.4.2 of OB Survey Manual, all the outsourcing proposals received from OC mines are to be entered in a register and then movement is to be monitored. Only proposals against which orders were issued are, however, being maintained.

- As per para 3.14 of OB Survey Manual, all records and plans of each closed work order shall be carefully numbered, bundled, sealed and should be kept under safe custody of the Project Officer. These instructions were not being followed in any of the mines.

- In respect of OB removal by the Company’s men and HEMM, the mine authorities prepare a statement of OB removed but no test check or verification or cross checks are conducted.

The Management stated (October 2006) that as a part of its own efforts towards constant improvisation of the systems and procedures and in the light of the audit observations, the Company had constituted a committee of senior officers to examine in detail the issues raised by Audit and make concrete recommendations for any modifications to be carried out in the existing systems and procedures in operation of OB removal contracts.

The above findings were reported to the Government (September 2006) ; their reply is awaited (October 2006).

Acknowledgement

Audit acknowledges the co-operation and assistance extended by the staff and the Management of the Company at various stages of conducting the performance audit.

Conclusion

Performance of the Company with regard to removed of over-burden suffered due to various deficiencies like non-consideration of projections in the Feasibility Reports while preparing out-sourcing proposals, acceptance of Earnest money deposits in the form of Fixed Deposit Receipts instead of demand Drafts and award of contracts without indicating the quantity of top-soil. Proposals for outsourcing relating to the same mine were not processed simultaneously resulting in additional cost of over burden removal. Price variation clause was not deleted despite the company's decision to supply diesel and explosives. Bonus and penalties were worked at bulk procurement price, whereas price variation clause was applied at retail price. Provisions contained in Over Burden survey manual were not followed for monitoring of dump height and depth of the mine which made the estimates unrealistic. The deployment of Heavy Earth Moving Machinery was not monitored by the Company.

Recommendations

- ***The Company should prepare an OB removal contract manual.***
- ***The Company should take steps for vendor development so that monopolisation of over-burden removal work with a few contractors can be avoided.***
- ***The Company should fix norms for drilling and consumption of explosives, and should levy penalties for short excavation.***

- ***Actual meterage drilled, dump height, quarry depth, operated lead, explosives consumption per bcm and the actual heavy earth moving machinery deployed should be recorded in the measurement book and compared with the figures proposed by the mines.***

2.2 Tariff, Billing and Collection mechanism in Southern Power Distribution Company of Andhra Pradesh Limited

Highlights

Southern Power Distribution Company of Andhra Pradesh Limited was incorporated on 30 March 2000 as a subsidiary of Transmission Corporation of Andhra Pradesh Limited to takeover the retail distribution of power in six out of 23 districts in the State. The performance review of tariff, billing and collection of revenue mechanism followed by the Company revealed the following:

- The Company did not adhere to the quota fixed by APERC for drawal and sale of energy to subsidised category of consumers.
- The estimation of agriculture consumption done by the Company was not realistic.
- There were cases of wrong application of tariff and incorrect billing leading to loss of revenue.

(Paragraphs 2.2.1, 2.2.8, 2.2.12 to 2.2.23 and 2.2.28)

The Company suffered loss of Rs. 359.72 crore due to sale of power in excess of the quota fixed by Andhra Pradesh Electricity Regulatory Commission (APERC) in respect of subsidised categories during 2001-02 to 2005-06.

(Paragraph 2.2.8)

The Company did not apply Bulk Supply Tariff rate for excess sale of power to the RESCOs resulting in short billing of revenue by Rs. 14.83 crore.

(Paragraph 2.2.9)

There was short billing of Rs.27 crore on account of wrong categorisation of services and non-adherence to tariff conditions.

(Paragraphs 2.2.13 to 2.2.23)

The Company extended concessional tariff to ineligible consumers without ensuring fulfilment of the criteria, which led to loss of revenue of Rs.5.67 crore.

(Paragraph 2.2.25)

Introduction

2.2.1 Southern Power Distribution Company of Andhra Pradesh Limited (APSPDCL), one of the four distribution companies in the State was incorporated (30 March 2000) as a subsidiary of Transmission Corporation of Andhra Pradesh Limited (APTRANSCO) a wholly owned State Government company, to take over the retail distribution of power from APTRANSCO in an area covered by six * out of 23 districts in the State.

The Company started commercial operations with effect from 1 April 2000. The business of retail distribution of power for the first year of operation was carried out by APTRANSCO on "no profit no loss" basis. The Company was granted sole distribution and retail supply licence with effect from 1 April 2001 for carrying on its business in the designated areas.

The Management of the Company is vested in a Board of Directors consisting of seven Directors including the Chairman and Managing Director. The Managing Director being the Chief Executive of the Company looks after the day-to-day operation and is assisted by four functional directors for Finance, Projects and Material Management, Operations and Human Resources Development (HRD) and Regulatory Affairs. The area of operations is divided into six operating circles, each headed by a Superintending Engineer (SE) Operation. Circle offices have three to five Divisional Engineers (DEs) offices and 10 to 14 Electricity Revenue Offices (EROs) under their control to look after day-to-day operational and financial matters.

A review on Tariff, Billing and Collection of revenue-Transmission Corporation of Andhra Pradesh Limited (erstwhile Andhra Pradesh State Electricity Board) was included in the Report of the Comptroller and Auditor General of India (Commercial) for the year ended 31 March 2000.

Scope of audit

2.2.2 The matters relating to tariff, billing, collection and allied issues, covering the period of five years from 2001-02 to 2005-06 were examined at the corporate office and four operation circles viz., Guntur, Nellore, Kadapa and Chittoor. Out of 16 DEs and 47 EROs falling under these four circles, records of eight DEs and 11 EROs were examined. HT services to the extent of 25 *per cent* under the jurisdiction of each of these four circles were checked in audit. A general examination of LT services was also conducted.

* Chittoor, Guntur, Kadapa, Krishna, Nellore and Prakasham

Audit objectives

2.2.3 The performance review of the tariff, billing and collection mechanism in the Company was conducted with a view to ascertain whether:

- input costs and returns were included in the tariff fixation as per the directions of the Andhra Pradesh Electricity Regulatory Commission (APERC);
- billing process was carried out efficiently;
- the collection of revenue was prompt and accountal of the same was appropriate; and
- effective efforts were made to realise the revenue arrears.

Audit criteria

2.2.4 The following audit criteria were adopted:

- Annual Revenue Requirements (ARRs) filed with APERC;
- Billing schedule, tariff orders, distribution guidelines/orders issued by APERC and the Company;
- Procedure prescribed for supply of electricity;
- Guidelines for sale of power to subsidised and non-subsidised categories of consumers and incentive scheme for HT consumers as issued by APERC and tariff orders;
- Internal control / procedures prescribed.

Audit methodology

2.2.5 The methodology adopted for attaining the audit objectives were examination of:

- guidelines/directives issued by APERC and the State government for drawal/sale of energy to different categories of consumers;
- agenda and minutes of the Board meetings;
- agreements executed with consumers, billing files and terms and conditions stipulated for supply of power;
- effectiveness in recovering the revenue from consumers; and
- issue of audit enquiries and interaction with the Management.

Audit findings

2.2.6 Audit findings arising as a result of the performance review were reported to the Government/Company in June/August 2006. These were discussed in the meeting of the Audit Review Committee on State Public Sector Enterprises held on 26 September 2006 which was attended by the Special Chief Secretary to the Government (Energy Department) of Andhra Pradesh and Chairman and Managing Director, APTRANSCO and Chairman and Managing Director and Director (Finance) of the company. The views expressed by the members have been taken into consideration while finalising the review.

Audit findings are discussed in the succeeding paragraphs.

Tariff

2.2.7 APERC formed in March 1999 under the Andhra Pradesh Electricity Reforms Act, 1998 is responsible for issue of retail and bulk supply licences for distribution and transmission of power, fixation of tariff and other regulatory matters.

Tariff is fixed by APERC on the basis of proposals submitted by the company

In terms of section 26(5) of the Reforms Act read with guidelines for revenue and tariff filing framed (October 1999) by APERC the licensee is required to file every year before 31 December its ARR report relating to each licensed business for the ensuing financial year. The ARR contains the anticipated aggregate revenue requirement, revenue from tariff charges and revenue gaps with explanation as to how the gaps are proposed to be covered. On the basis of ARR, APERC determines the quantity of energy to be purchased and sold by the licensee, ceiling for transmission and distribution (T&D) losses, etc., and finalises the tariff applicable for a particular year. The Company filed its first tariff proposals with APERC for the year 2001-02 in December 2000. APERC has so far (September 2006) approved and issued six tariff orders for the years 2001-02 to 2006-07 on the basis of tariff proposals submitted by the Company every year.

Non-regulation of power supply within the prescribed limits

2.2.8 As per the policy of the State Government, the Company is not entitled to claim/receive subsidy in case sales to subsidised categories exceed quantities approved by APERC. In case of sales being less than the quota fixed for each subsidised category of consumers, the subsidy received in excess is required to be refunded to the Government.

The details of the categorywise quantity of energy approved by APERC and the actual and excess drawal of power by the respective categories, cost to serve, average realisation and loss due to excess drawal of power by subsidised categories are indicated in **Annexure -12**. It would be observed from the details in the annexure that :

The company suffered a net loss of Rs.359.72 crore due to sale of power in excess of quota fixed

- The Company suffered loss of Rs. 359.72 crore due to sale of power in excess of the quota fixed by APERC in respect of subsidised categories i.e. LT Category I, IV, V, VI and HT Agriculture during the years 2001-02 to 2005-06.

- During the year 2001-02, the Company overdrew 773.45 million units (MU) of power resulting in extra payment of Rs. 10.75 crore as overdrawal surcharge at the rate of 13.9 paise per unit. Out of this, 723.14 MU (94 *per cent*) were consumed by subsidised categories. No overdrawal surcharge rates were, however, prescribed by APERC for subsequent years

The Government stated (September 2006) that actual requirement exceeded the historical data and projections because of unprecedented drought conditions, which was an uncontrollable factor and drawal of power by subsidised categories could not be restricted as all the consumers were drawing power from the same distribution system. The reply is not tenable since the APERC, while approving the ARR, did not accept the contention of the company and levied overdrawal surcharge.

Non-application of bulk supply tariff rate for excess sales

2.2.9 The Company supplies power to Rural Electric Supply Cooperative Societies (RESCOs) under subsidised category at the rates approved by the APERC. APERC prescribed (22 July 2003) the Bulk Supply Tariff **(**BST) rate applicable for sales made to RESCOs over and above the fixed quota. There were three cooperative societies[***] falling under the jurisdiction of the company for retail distribution of power to consumers in their areas out of which two societies (Rayachoti and Atmakur) were taken over by the company with effect from 1 January 2005 as per Government orders.

Audit analysis revealed that during 2002-03 to 2005-06, 146.26 MU of power was supplied to these three societies (except Rayachoti in 2002-03 and Kuppam in 2003-04) in excess of the quota fixed by the APERC, but were billed at subsidised rates instead of at the BST rate, resulting in short realisation of revenue of Rs. 19.58 crore.

Loss of revenue of Rs.14.83 crore due to incorrect application of rate on excess drawal of power by RESCOs

The Government stated (September 2006) that the Rayachoti and Atmakur RESCOs were merged with the company with effect from 1 January 2005; hence the shortfall for the year 2004-05 was not levied. It was, however, noticed in audit that even after excluding the recoveries in respect of the merged RESCOs from 2004-05 onwards, non-claiming of energy charges at BST rates resulted in loss of revenue of Rs.14.83 crore.

Non-fixing of demand charges for railway traction services

2.2.10 Cost of power comprises two types of charges, i.e., energy charges and demand charges. Energy charges comprise various variable costs of total

[***] Atmakur (Nellore District), Rayachoti (Kadapa District) and Kuppam (Chittoor District)

power purchase whereas demand charges comprise the fixed costs including the network costs. If the recorded maximum demand (RMD) of a consumer exceeds his contracted maximum demand (CMD), the excess is billed at twice the normal demand charges. CMD is an important factor for deciding on the transmission and distribution (T&D) infrastructural arrangements and excess drawal of power over and above the CMD causes damage to the system, line losses and also results in poor quality of power supply to other consumers.

It was noticed in audit that APERC, on the basis of the ARR proposals submitted by the Company, had fixed single part tariff for railway traction services and there was no provision for any separate demand charges. In two railway traction services of Guntur circle, it was noticed that RMD exceeded the CMD by four to 187 *per cent* during the period 2001-02 to 2005-06. The quantification of loss on this account was, however, not possible in the absence of a separate component for demand charges in the tariff structure.

Thus, it would be in the interest of the company if demand charges for railway traction services are also fixed.

The Government stated (September 2006) that the issue was pending for detailed evaluation with APERC.

Billing

2.2.11 The billing and collection mechanism to be followed by the State power distribution companies (Discoms) was laid down in the terms and conditions of supply of erstwhile Andhra Pradesh State Electricity Board (APSEB) applicable to APTRANSCO/Discoms. Guidelines for billing and collection are also issued by APERC from time to time. Consumers with a contracted demand of 70 KVA and above and/or having a connected load exceeding 75 HP/56 KW are treated as High Tension (HT) consumers. All others are treated as Low Tension (LT) consumers. As on 31 March 2006 there were five categories under HT and eight categories under LT (depending upon the nature/purpose of consumption of power).

Wrong categorisation of services

Supply to townships, residential colonies etc.

2.2.12 As per the tariff orders issued from time to time, railway stations falling under HT category are to be billed under HT category II. Lower tariff under HT- VI category is, however, applicable to consumers under HT-I to HT –V category and bulk domestic consumers who use HT supply exclusively for townships, residential colonies etc., on the condition that the connected load for such use was within the limits specified hereunder:

Water supply & sewerage and street lighting put together	10 *per cent* of total connected load
Non-domestic/commercial and general purpose put together	10 *per cent* of total connected load

The deficiencies noticed by Audit in categorisation of consumers are discussed in the succeeding paragraphs.

The company suffered a loss of Rs.3.88 crore due to incorrect billing and wrong categorisation of railway stations

Railway Stations

2.2.13 Non-domestic/commercial load of eight railway stations exceeded 20 *per cent* of the total connected load; the classification of these services continued to be under HT-VI and had not been charged under HT-II category. This resulted in short billing/collection of revenue by Rs. 3.88 crore during the period 2001-02 to 2005-06.

The Government stated (September 2006) that the company had realised Rs.1.81 crore towards the shortfall amount and the balance shortfall amount had been billed and recovery was being pursued.

Somasila Project Colony

2.2.14 Connected load of water works, sewerage and streetlights put together of Somasila Project colony exceeded 10 *per cent* of the total connected load; but the service was categorised and billed under HT-VI category. This resulted in short billing of Rs.49.89 lakh during the period from 2001-02 to 2005-06.

Water pumping by Tirumala Tirupathi Devastanams

Wrong categorisation of service to TTD resulted in short billing of Rs.4.52 crore

2.2.15 Two service connections which were released to Tirumala Tirupathi Devastanams (TTD) for bringing drinking water from Kalyani Dam to Tirumala were being billed under HT category VI. Since the power is not being used for any townships or residential colonies, the consumers should have been billed under HT category II. Wrong categorisation resulted in short billing of Rs.4.52 crore for the period from 2001-02 to 2005-06.

The Government stated (September 2006) that billing of two services of TTD was being done under HT category VI as per the orders of AP Transco issued in January 2000 and the subject had been referred to APERC for clarification. Necessary action would be taken after receipt of the clarification.

Wrong categorisation of services to TTD and Railways resulted in short billing of Rs.9.60 crore

TTD and Railway colonies

2.2.16 Three service connections of TTD and two service connections of railways having connected load in excess of 10 *per cent* for water supply and street lighting were being billed under HT category VI instead of HT category II. Wrong categorisation resulted in short billing of Rs.9.60 crore during 2001-02 to 2005-06.

The Government stated (September 2006) that field officers were instructed to inspect the three services of TTD and two services of railway colony and Somasila Project colony service and to furnish actual connected load for common facilities. It was further stated that necessary action would be taken after receipt of the above information from the field offices.

Irrigation and Agricultural Consumption

Krishna Barrage

Wrong categorisation of Krishna Barrage service under lift irrigation scheme resulted in short billing of Rs. one crore

2.2.17 During the review of HT IV (Irrigation and Agricultural purposes upto 2001-02) and HT IV (A) (Government Lift Irrigation Schemes from 2002-03 onwards) services, it was noticed by audit that the electricity connection released for Krishna Barrage was categorised and billed under HT category IV-A. The service is, however, being used for harnessing water resources for irrigation, drinking water purposes and for meeting the water requirements of industries (Vijayawada Thermal Power Station). As such, the service is not a 'Government Lift Irrigation Scheme' and should have been categorised under HT II category. Wrong categorisation resulted in short billing of Rs. one crore for the period 2001-02 to 2005-06.

The Government, while admitting the facts, stated (September 2006) that the consumer category has been changed from HT category IV to HT category II with effect from September 2006 and short billed amount for the two years upto March 2006 would be included in the current consumption (CC) bill for September 2006. The short billed amount for the earlier years could not be claimed due to limitation of time as per Section 56(2) of the Electricity Act 2003. Thus due to initial wrong categorization and subsequent delay in change of category of the consumer, the Company could not claim an amount of Rs.61.18 lakh for the period from 2001-02 to 2003-04.

Bapatla Agricultural College

2.2.18 Bapatla Agricultural College farm/premises was being billed under HT category IV/IV (A). It was, however, observed that since the agricultural college is an educational institution, billing the service under HT category IV/IV (A) is not correct, and should have been categorised under HT II category. Wrong categorisation of service has resulted in short billing of Rs. 18.67 lakh from April 2001 to January 2006.

The Government stated (September 2006) that the supply was for a Government institution and was predominantly for agricultural purpose. The reply is not tenable as the supply was for research and demonstration to the students of agricultural courses and not for agricultural purposes.

Extension of concessional tariff to ineligible consumers led to loss of revenue of Rs.6.16 crore

Small Scale Industries

2.2.19 Consumers having contracted demand of less than 70 KVA and/or having connected load of 75 HP and below are considered as LT consumers. An optional/concessional category (LT-III B) introduced (February 1999) by the erstwhile Andhra Pradesh State Electricity Board was being continued by the Company to the consumers having connected load exceeding 75 HP, but less than 150 HP subject to certain conditions. The important and foremost condition for being billed under this category was that the consumer should possess Small Scale Industrial (SSI) registration. In the absence of SSI registration, the consumer was to be billed under HT category-I. Audit scrutiny of LT-III (B) consumers under Kadapa and Chittoor circles revealed that 173 consumers as on 31 March 2006 did not qualify for the concessional tariff as they did not have SSI registration. Thus, extension of concessional tariff to 173 ineligible consumers resulted in loss of Rs.6.16 crore for the years 2001-02 to 2005-06.

The Government stated (September 2006) that SSI certificates would be verified and action taken to levy shortfall wherever SSI certificates were not available.

Low Tension Industrial Category

2.2.20 As per the tariff orders issued, LT category III (A) tariff is applicable for supply of electricity to LT industrial consumers with a contracted/connected load of 75 HP/56 KW and below.

The Company has wrongly classified eight services having connected/contracted load of more than 75 HP under LT category III (A) instead of HT category I/II which has resulted in short billing of Rs.30.23 lakh during the years 1999-2000 to 2005-2006.

The Government stated (September 2006) that the loads in all the cases have been regularised by reducing the load except in one case which was stated to be under consideration by the Company. The collection of the short billed amount has, however, not been intimated.

Short Billing

Billing of demand charges in phased release of power

2.2.21 In case of consumers who were sanctioned phased contracted demands, the consumers may seek deferment or cancellation of further phased demand by giving three months' notice in advance or in lieu thereof pay three months' charges towards such deferment or cancellation of phased demands. For the purpose of billing, demand would be the maximum demand recorded during the month (RMD) or 80 *per cent* of the contracted maximum demand (CMD) whichever is higher.

Audit scrutiny revealed that in two cases of phased release of power, consumers were billed demand charges only on the basis of RMD, disregarding the CMD aspect altogether, resulting in short billing and consequent loss of revenue of Rs. 21.88 lakh (January 2001 to November 2005) and Rs. 15.82 lakh (July 2001 to January 2006) respectively. In both the cases the consumers did not seek any deferment/cancellation of phased demands.

The Government, while admitting the fact, stated (September 2006) that the short billed amount would be included in the current consumption bill for the month of August 2006 and collection particulars would be intimated.

Non-levy of energy charges applicable for specified voltage

2.2.22 The tariff order for the year 2005-06 prescribed the energy charges based on the voltage levels specified in the tariff at which the supply is to be availed.

It was, however, observed in audit that in respect of 10 HT consumers of Chittoor circle, the billing was done at the energy rate applicable for actual voltage instead of specified voltage. This resulted in short billing of Rs.36.23 lakh for the period April 2005 to March 2006.

The Government stated (September 2006) that due to availing of supply at higher voltage, the technical losses would be normally reduced and there would not be any additional burden on the transformers; hence advantageous to the Company. The reply is not relevant as the audit observation relates to non-raising of bills as per the Tariff Order.

Short billing of LT service

2.2.23 In case, for any valid reason, an HT meter is installed for an LT service, the energy recorded shall be deducted by three *per cent* for the purpose of billing at the applicable LT tariff. In cases where the tariff condition stipulates metering by HT for certain LT categories, such deduction (at three *per cent*) shall not be made as per Clause 22.1.3 of Terms and Conditions of Supply. Further, note V (b) under LT category III (A) in the Tariff Order stipulates that for loads of services between 50 HP and 75 HP HT metering will be provided. It was observed by audit that in 176 such cases of LT services metering was provided on HT side as per tariff order but three *per cent* deduction was being made erroneously which resulted in short billing of Rs.11.50 lakh for the period from November 2003 to March 2006.

The Government stated (September 2006) that as per the instructions issued by the company (4 August 2005) in the case of LT category III (A) –Normal tariff where HT metering is provided, 3 *per cent* of energy recorded is to be deducted for the purpose of billing. This is not tenable as internal instructions of the company cannot prevail over the tariff conditions.

Undue favour to consumers

Non-levy of electricity duty

Non-levy of electricity duty on AIR, DD, Railway colonies and Science centre resulted in loss of Rs.21.06 lakh

2.2.24 Electricity Duty (ED) is recoverable from all the consumers or category of consumers except the categories specifically exempted under AP Electricity Duty Act and Rules. The categories of consumers which are specifically exempted from levy of ED under section 3(1) of the Act include the Government of India offices (not the Central Government Undertakings), Railway tractions, Railway stations, Railway authority offices (not railway residential colonies), all agricultural consumers, etc.

It was observed in audit that:

- ED was not levied in the bills raised for the electricity supplied for the residential colony of Sriharikota Rocket Launching Centre (SHAR) (from 2001-02 to 2005-06) resulting in short billing to the extent of Rs. 8.09 lakh. As the service was released for the purpose of residential lighting, etc. (not for Government office), non-levy of ED was not justified.

- The Company did not levy ED on two services of All India Radio (AIR) and Doordarshan (DD) at Kadapa and Tirupathi wrongly presuming them to be under the category of Government offices. As the AIR and DD ceased to be Government offices (1997) after formation of Prasar Bharati, a central autonomous body, they were no longer exempted from ED. This resulted in short billing of Rs. 6.75 lakh for the years 2002-03 to 2005-06.

- The Company did not levy ED in respect of four services in Chittoor circle (two Railway residential colonies, Railway community hall and Regional Science Centre) treating them as Government offices. Since these services were not Government/Railway offices, the same were not eligible for exemption. The short billed ED for the years from 2001-02 to 2005-06 worked out to Rs.6.22 lakh.

- The Company did not levy ED of Rs.5.81 lakh for the period from November 2004 to February 2006 to one ferro-alloy manufacturer in Nellore circle on the ground that it was exempted from ED under the Government Order (GO) dated 28 October 2003. The G.O, however, exempts levy of ED only on the captive power generated and consumed by ferro-alloy manufacturers themselves and not on the power supplied by the Company. Thus, non-levy of ED on the power supplied by the Company to the ferro alloy manufacturer was not as per the orders of the Government.

The Government, while confirming the collection of short-billed ED of Rs.8.09 lakh from SHAR stated (September 2006) that Prasar Bharathi is still under the control of the Central Government and hence would not attract ED. It was further stated that the matter of levying ED on the ferro-alloy unit has been referred to the Government authorities for clarification.

The reply regarding Prasar Bharathi and ferro alloy unit is not tenable as Prasar Bharathi is an independent body and was not covered under the definition of 'Government of India office' for the purpose of claiming exemption from ED. Further, the GO providing for exemption of ED to ferro alloy units on their own generation is not applicable for the power supplied by the Company to ferro alloy units.

Extension of incentive to ineligible HT consumers

2.2.25 The Company, with the approval of APERC, introduced incentive by way of discount on tariff for HT-I (A) consumers with effect from 2001-02. As per the guidelines prescribed by APERC vide Tariff Order for 2001-02, two conditions were required to be satisfied by the existing consumers to be eligible for the incentive, i.e., monthly consumption of a consumer should be in excess of average monthly consumption for the year 2000-01 and the power load factor should be above the threshold level of 30 *per cent*. The incentive was to be made available on telescopic basis[♣]. New consumers who joined in 2001-02 were also made eligible by the Company for the incentive, disregarding the first condition.

APERC, however, vide Tariff Order for 2002-03, excluded the term 'new consumers' from the eligibility for incentive, while retaining the two conditions as stated above. The tariff order further prescribed that the incentive was to be made available on non-telescopic basis[♥]. This indicated that consumers existing during 2000-01 only were eligible for the incentive.

It was noticed in audit that:

- Changing the basis of incentive from 'telescopic' to 'non-telescopic' by APERC was not based on any cost benefit analysis and was not in the financial interest of the Company.

Incentive of Rs.5.67 crore was extended to consumers who were not eligible

- The Company extended the incentive even to those HT-I (A) consumers who joined in 2001-02 and thereafter during the years 2002-03 to 2004-05 on fulfilment of one of the conditions viz., monthly consumption being above threshold load factor level of 30 *per cent* ignoring the other condition regarding monthly consumption being in excess of average consumption of the base year 2000-01. Thus, the incentive was extended to new consumers who had taken service connections in 2001-02 and thereafter. This resulted in payment of incentive aggregating Rs. 5.67 crore to ineligible HT consumers during 2002-03 to 2004-05.

The Government stated (September 2006) that new consumers were also eligible for incentive only on the basis of load factor, though they were not existing in the base year 2000-01 and the incentive allowed was as per the APERC approval. The reply is not acceptable as the tariff orders for 2002-03 to 2004-05 did not specifically include the term "new consumer" for eligibility and the consumption had to be compared with that of 2000-01 as base. Besides, the tariff order clearly indicated that consumers who existed in the year 2000-01 only were eligible for incentive from 2002-03 onwards.

[♣] Calculating the incentive at the relevant rates of the slabs in which the consumption falls.
[♥] Calculating the incentive at the single rate (usually higher) applicable for the entire consumption based on the slab range in which the consumption falls

Belated levy of fuel surcharge adjustment (FSA)

2.2.26 The Company recovers the variation in the actual power purchase cost vis-a-vis the approved cost due to price variance and fuel variance by levy of fuel surcharge adjustment (FSA). APERC issued orders for levy of FSA for the second and third quarters of 2000-01 on 18 June 2001 and 6 December 2001 respectively. As per APERC orders, the Company should have notified the orders within three days of their issue and before two/three weeks of raising the bill for FSA.

Due to delay in levy of FSA, the company suffered loss of interest to the extent of Rs.1.58 crore

It was noticed in audit that the Company levied FSA with abnormal delays. The FSA for the second and third quarters was levied in the months of September 2002 to November 2002 and January 2003 to March 2003 respectively. Due to delay in levy/collection of FSA, the company had to forgo the opportunity of early realisation of revenue to the extent of Rs. 21 crore with consequential loss of interest of Rs. 1.58 crore. (at the interest rate of 13 *per cent* i.e. the interest rate being paid on borrowings).

The Government stated (September 2006) that the cost of levying FSA as a separate bill, collecting and accounting did not seem to be economical and hence it was being levied along with current consumption bills. The reply is not tenable as the orders of the APERC were mandatory and should have been implemented in the next billing cycle without undue delay in the Company's interest.

Assessed Sales

2.2.27 Sale of energy to metered categories consists of two parts viz., metered units and assessed units. Assessed units refer to the units billed to consumers in case the meter reading is not available due to meter defects, door lock, etc. After analysing the sales database of Discoms, APERC, vide tariff order for 2003-04, stipulated that the assessed sales should not exceed three *per cent* of metered sales from the year 2003-04. In the cases indicated in the table below the ratio of assessed sales (units) to metered sales of LT categories exceeded the prescribed *percent*age during the years 2003-04 to 2005-06 (except LT-IV for 2003-04 and 2004-05):

Category		2003-04	2004-05	2005-06
LT-I	Domestic	4.93	3.40	3.78
LT-II	Non-Domestic	4.67	4.47	4.39
LT-III	Industrial	16.70	16.92	13.28
LT-IV	Cottage Industries	2.75	2.24	4.61
LT-VI	Public utilities	57.80	94.12	75.67
LT-VII	General	52.93	5.63	6.26
	Total	10.23	13.25	12.13

From the above details, it is noticed that:

- Ratio of total assessed sales to metered sales increased from 10.23 *per cent* in 2003-04 to 12.13 *per cent* in 2005-06.
- Assessed sales were very high ranging from 58 to 94 *per cent* in respect of LT category VI consumers (Street Lights and Public Water Works), which need concerted efforts to put the metering system in place.
- Assessed sales of LT Category- III consumers (Private industries) were ranging from 13.28 to 16.92 *per cent* of metered sales.

The impact of assessed sales in lieu of metered sales is, however, not quantifiable.

Incorrect estimation of agricultural consumption

Estimation of agricultural consumption is inappropriate compared to the actual hours of supply of power

2.2.28 The Company followed various methodologies to estimate the agricultural consumption/sales (unmetered). In accordance with APERC direction (October 2002), the company prepared a database showing the details of number of mandals where agricultural consumption took place, number of agricultural pumpsets in each mandal and connected load of each agricultural pumpset. On the basis of readings obtained from meters fixed at selected distribution transformers (DTRs) in selected villages in each mandal, agricultural consumption is arrived at after extrapolation for the entire population of pumpsets. In the absence of independent meters for each agricultural connection the consumption arrived at on the basis of sample meters installed in selected DTRs could not be vouchsafed.

Audit scrutiny of agricultural consumption/sales estimated revealed the following:

- During 2004-05 in four out of six circles, sample size of pump sets (having valid metered DTRs) adopted was 1.74 to 4.15 *per cent* which was not adequate.

- It was noticed that adopted hours of supply to sample DTRs were exceeding seven hours i.e. the actual hours of supply to agricultural consumers resulting in over estimation which is not quantifiable.

  The Government stated (September 2006) that it was because the pumpset capacities might have been increased by the farmers due to various reasons and accordingly the recorded consumption (kwh) will be more. But, the connected load (HP) continued to be taken based on the census data only.

  The reply is not tenable as the Company is not calculating the correct amount of agricultural consumption for the sample itself. The Company should have updated the data base in order to arrive at the correct agricultural consumption for the sample DTRs and to further estimate total agricultural consumption.

- The company considered the average line losses of 5.47 *per cent* for estimating the agricultural consumption for 2004-05 and 2005-06. As against this, the line losses actually accepted by APERC for wheeling purposes in respect of these two years were at nine *per cent* and 8.52 *per cent* respectively. Thus, adoption of line losses on the lower side resulted in over estimation of agricultural consumption, the extent of which was not quantifiable.

  The Government stated (September 2006) that the percentage of line losses adopted for assessment of agricultural consumption was approved by APERC and it is not appropriate to consider nine *per cent* of line losses for all the feeders.

Collection of Revenue

2.2.29 The salient features of the collection mechanism being followed by the Company are as follows:

- Revenue billed in respect of HT services is collected at collection counters located at every circle office.

- In respect of LT services, electricity bills are generally collected by the revenue cashiers (RC) except in some areas where collection work is entrusted to certain private collection agencies.

- HT consumers are required to pay current charges within 15 days and LT consumers within 14 days from the date of the bills, failing which the consumers are liable for payment of additional charges of 0.07 paisa per rupee per day of delay on the amount of the bill for the period of delay.

- With effect from August 2003 revenue billed in respect of certain categories (I, II and VII) of LT consumers was also collected through e-Seva centres situated in municipal towns.

Collection efficiency

2.2.30 The table below indicates the balances outstanding at the beginning of the year, revenue assessed during the year, revenue collected and the balance outstanding at the end of the year during the last five years ending 2005-06.

(Rupees in crore)

SL No	Particulars	2001-02	2002-03	2003-04	2004-05	2005-06
1	Balance outstanding at the beginning of the year	198.64	212.41	229.40	145.13	228.44
2	Revenue assessed/Billed during the year	1514.04	1892.34	1881.60	1991.41	2222.00
3	Total amount due for realisation (1+2)	1712.68	2104.75	2111.00	2136.54	2450.44
4	Amount realised during the year *	1500.27	1796.17	1965.87	1908.10	2149.60

5	Amount written off during the year	--	79.18	--	--	(-)7.61
6	Balance outstanding at the end of the year	212.41	229.40	145.13	228.44	308.45
7	Percentage of amount realised to total dues (4/3)	87.60	85.34	93.13	89.31	87.72
8	Arrears in terms of No. of months assessment	1.68	1.45	0.93	1.38	1.67

*Derived figure (Sl.no.3-Sl.no.6)

The category-wise outstanding dues at the end of the five years' period (2001-02 to 2005-06) and the percentage increase during 2005-06 over the year 2001-02 is given in the following table

(Rupees in crore)

Category	**Outstanding dues as on 31 March**					**Percentage increase during 2005-06 over 2001-02**
	2002	**2003**	**2004**	**2005**	**2006**	
LT-I-Domestic	52.45	44.20	66.03	100.07	140.68	168
LT –II-Non-domestic	8.73	(6.17)	1.47	6.90	30.82	253
LT –III-Industrial	9.29	9.31	11.85	14.41	27.54	196
LT –IV-Cottage industries	0.14	0.38	0.49	0.55	0.75	435
LT –V-Irrigation and Agriculture	73.82	128.98	(4.46)	(7.61)	12.08	--
LT -VI-Public Lighting	10.86	(12.45)	(1.76)	6.98	11.39	5
LT –VII-General	1.88	1.84	1.86	2.38	3.82	103
LT –VIII-Temporary	0.03	(0.02)	0.01	0.01	0.02	--
HT-I-Industrial/Segregated	21.19	5.27	9.19	26.02	46.56	120
HT-II –Industrial/Non segregated	2.96	2.86	3.15	4.80	5.95	101
HT-IV-Irrigation and Agriculture	0.13	0.67	0.31	0.74	0.86	561
HT-V-Railway traction	13.98	30.52	16.88	17.14	17.14	23
HT –VI- Colony	0.56	0.49	1.30	0.75	0.99	77
HT Temporary supply	0	0	0	0.03	0.03	--
HT RESCO	16.39	23.52	38.81	55.28	9.82	--
Total	**212.41**	**229.40**	**145.13**	**228.44**	**308.45**	**--**

Note: Figures in brackets in respect of the subsidized categories (categories LT.V & VI) indicate the grant/subsidies received in advance from the Government but pending adjustment against their dues. Bracket figures in respect of other categories (LT-II-non-domestic and LT.VIII) are recoveries effected against the provisional billing pending reconciliation.

It may be observed from the above details that:

- The balance dues outstanding at the end of the year increased from Rs.145.13 crore in 2003-04 to Rs.308.45 crore in 2005-06.
- Outstanding dues from LT categories I, II, III, IV, VII and HT categories I, II and IV have increased by more than 100 *per cent* during the last five years .

- Age-wise analysis of above outstanding dues as on 31 March 2006 as shown in the Demand, Collection and Balances (DCB) for the quarter ending 31 March 2006 further indicated that:

❖ some of the dues (Rs.7.30 lakh) pertaining to the periods upto 1980-81 were also pending.

❖ Dues outstanding for more than three years amounted to Rs. 85.43 crore (22 *per cent* of the total dues) consisting of dues from LT categories (Rs. 46.03 crore) and HT categories (Rs.39.40 crore). This indicated ineffective persuasion of old debts.

❖ Group-wise analysis of debts outstanding as on 31 March 2006 revealed that an amount of Rs.113.55 crore was due from 'disconnected services'.

Collection of current charges bills through e-Seva

2.2.31 As per the direction of the State Government (December 2003), collection of electricity bills (LT category I, II and VII) was to be entrusted to e-Seva centres on payment of service charges of Rs.5 (urban areas) and Rs.3.50 (other than urban areas) per bill. The Company, however, entered (April 2004) into an agreement with the Director, e-Seva, Government of Andhra Pradesh, operative retrospectively from August 2003, as per which the Company agreed to pay Rs. 5 per transaction from the date of execution of work irrespective of whether the areas covered were urban or non urban.

A review of the service charges paid indicated that CC bills of the Company were being collected at e-Seva centres in 42 municipalities and towns of Guntur, Nellore, Kadapa, Chittoor and Krishna circles. The details of the number of municipalities/towns where e-Seva services were availed of, the number of urban centres as approved, number of actual transactions and excess amount paid for the period 2003-04 to 2005-06 are as indicated below:

Circle	Number of e-Seva centres where service is availed	Number of urban centres as approved	Number of non-urban centres paid at Rs.5 instead of Rs.3.50	Number of transactions in non-urban centres in lakh	Excess payment (Rupees in lakh)
Guntur	12	2	10	19.61	29.42
Nellore	10	1	9	3.61	5.42
Kadapa	2	1	1	10.35	15.52
Chittoor	5	2	3	10.67	16.00
Krishna	13	2	11	15.01	22.51
Total	**42**	**8**	**34**	**59.25**	**88.87**

The following points were noticed in audit:

Payment of service charges at higher rates to e-seva centres resulted in excess payment of Rs.88.87 lakh

- In violation of the Government's direction, payment of higher service charges at Rs.5 per transaction in other than urban centres was made which resulted in excess payment of Rs. 88.87 lakh (from August 2003 to March 2006) to e-Seva.
- The agreement with e-Seva was not renewed after its expiry in August 2004. Despite this, the service continued to be utilised and payments made to the e-Seva till date (March 2006).

The Government stated (September 2006) that the rate notified in the said G.O was applicable only for the AP On-line and not for the e-Seva centres. The reply is not tenable since the rates as prescribed in the GO were applicable to e-Seva centres also.

Non-collection of additional consumption deposit

ACD of Rs.11.47 crore not collected due to lack of pursuance

2.2.32 As per terms and conditions of supply, all consumers (except domestic consumers having monthly consumption up to 50 KWH) should keep with the Company an amount equal to two months (three months' upto 2003-04) consumption charges as consumption deposit (CD). Adequacy of CD is to be reviewed every year and the shortfall of existing deposits, if any, should be recovered from the consumer as Additional Consumption Deposit (ACD). Further, a surcharge at the rate of 18 *per cent* per annum is leviable in case of any delay in payment of ACD by the consumer. A review of the ACD pending collection indicated that ACD due as on 31 March 2005 and 31 March 2006 was Rs. 30.76 crore and Rs.33.47 crore respectively.

In reply, the Government confirmed (September 2006) collection of Rs. 25 crore against ACD from railway authorities etc., for the periods upto 2004-05 and Rs.22 crore against the demand of Rs.33.47 crore raised for 2005-06 and collection of the balance amount of Rs.11.47 crore was stated to be under progress. The fact, however, remains that the amount was collected belatedly and only after being pointed out by Audit. The Company should streamline the system of collection of ACD after review of its adequacy every year.

Delay in realisation of arrears

2.2.33 As per the procedure in vogue, the monthly current consumption (CC) charges bills towards railway traction services are to be realised invariably from the concerned railway authorities within the due date specified in the bills. Railway authorities have been deducting certain amounts from monthly CC bills raised by the Company on account of coal freight charges and demurrage charges etc., recoverable from Andhra Pradesh Power Generation Corporation Limited (APGENCO) towards settlement of their coal bills. APGENCO issues credit advices to APTRANSCO for the amount so deducted by railway authorities and APTRANSCO in turn passes it on to the company through credit advices. It was, however, observed in audit that an amount of Rs.9.98 crore (without surcharge for the belated payments) up to November 2004 was pending recovery from the Railways due to delay in receipt/adjustment of credit advices from APTRANSCO (March 2006). Thus, even after unbundling of the erstwhile Andhra Pradesh State Electricity Board, the Railway authorities have been continuing with the old practice of deducting the freight charges etc., payable by APGENCO. This cumbersome process is ultimately resulting in abnormal delay in receipt/ adjustment of CC charges from the Railway traction services.

The Government stated (September 2006) that the Company realised by way of adjustment from APGENCO an amount of Rs.3.51 crore out of Rs.9.98 crore pending as on 31 March 2006. The realisation of balance dues of Rs.6.47 crore is still pending (October 2006).

Outstanding dues from Tatkal consumers

Non-realisation of dues of Rs.5.97 crore from tatkal consumers due to ineffective pursuance by the Company

2.2.34 To mitigate the problem of large waiting list for agricultural connections, an out of turn/Tatkal scheme was introduced in 2002-03. The consumers of Tatkal scheme were to pay the electricity charges under category LT-V (B). The Company released 55112 connections under the scheme till 31 March 2006. Audit scrutiny revealed that out of the total demand of Rs.7.88 crore raised against the power supply to tatkal consumers during the four years up to March 2006, Rs.5.97 crore (76 *per cent*) was outstanding as on 31 March 2006.

The Government stated (September 2006) that as per the decision of the Government, dues (Rs.1.25 crore) for the periods up to 2003-04 had been booked under receivables from the Government and the Company was making special efforts for realisation of the balance dues from the tatkal consumers.

Improper accounting of sundry debtors

2.2.35 It was noticed in audit that different figures of Sundry debtors were being shown in the Balance Sheet, Financial Ledgers (FL) maintained at ERO/Circle level and Consumer Ledgers. The details of such balances after netting off the credit balances in certain accounts as at 31 March during 2001-2002 to 2005-2006 were as follows:

(Rs. in crore)

Year	Sundry debtors as per			Net off of credit balance done	Provision for bad and doubtful debts
	Balance Sheet	Financial Ledger (FL)	Consumer Ledger (CL)		
1	2	3	4	5	6
2001-02	212.41	218.06	209.79	NA	86.79
2002-03	229.40*	283.38	295.77	18.07	7.61
2003-04	145.13	121.49	134.32**	29.24	7.61
2004-05	228.44	200.74	174.46	19.17	7.61
2005-06	308.46	308.47	373.77	19.61	NIL

The following points were noticed in audit:

* After write off of Rs. 79.18 crore in 2002-03.

** After transferring Rs. 314.28 crore to receivables from Government of Andhra Pradesh towards agriculture category arrears.

The differences between consumer ledger and financial ledger were not reconciled

- Consumer Ledger contains details of consumerwise demand, collection and balance outstanding at the end of each month while Financial Ledger contains demand, collection and balance in a consolidated form. It would be noticed from the above table that the reconciliation of figures appearing in these two ledgers was not regular and prompt. In the absence of reconciliation of figures at regular intervals, correctness of recoverables booked in accounts was not susceptible of verification.

- A provision of Rs. 86.79 crore was transferred by APTRANSCO to the Company in the second statutory transfer order of the Government of Andhra Pradesh. Out of this, Rs. 79.18 crore was written off in 2002-03 without assessing individually the recoverability or otherwise of the outstanding amounts.

- The Company had the practice of netting off of advances received from consumers against debts outstanding, thereby diluting the correctness of receivables.

- APERC in its Tariff Order (March 2002) directed the company to vigorously pursue the review of receivables. The Company engaged (March 2003) 38 firms of Chartered Accountants for conducting the audit of receivables of Rs.154.49 crore relating to April 2000 to December 2002. It was noticed in audit that only three firms submitted their final reports, 34 firms submitted their draft reports (August 2003 and November 2004) and one firm did not submit any report so far (September 2006). The details of the amount collected after the audit by Chartered Accountants firms were not available. Thus, the purpose of appointing the firms of Chartered Accountants remained unfulfilled.

- Even after lapse of more than four years after receipt (March 2002) of direction of the APERC, the Company had yet (September 2006) to complete the audit of receivables and streamline their accounting.

The Government stated (September 2006) that the Company was in the process of identifying the differences to reconcile CL with FL and after completion of audit of receivables most of the differences would be sorted out.

Irregular write-off of unbilled revenue

2.2.36 Consequent upon the unbundling of APTRANSCO into four DISCOMS the assets and liabilities were distributed to four Discoms. As the actual collection against the provision for unbilled revenue transferred from APTRANSCO was found to be less by Rs.13.69 crore, the same was written off in 2002-03 without taking it up with the Government of Andhra Pradesh/APTRANSCO for reimbursement or reduction of liabilities.

The Government stated (September 2006) that the difference was due to omission of supplemental balances and there was no scope for the company to get the reimbursement. The reply is not tenable as the difference was due to a mistake and should have been corrected by corresponding allocation of additional assets or reduction of liability.

Deficient energy audit system

2.2.37 A concept of comprehensive energy audit was put in place in the erstwhile Andhra Pradesh State Electricity Board (APSEB) with the objectives to:

- identity the areas of high technical losses, commercial losses and take steps to reduce the same.
- arrive at system improvements necessary.
- accurately account for the units generated, units sold and the losses at each level.

A review of the energy audit reports/returns revealed the following:

- Though the monthly returns containing T & D losses were being sent to Corporate Office, total loss was not segregated into technical and commercial losses; data so collected was not analysed for identifying areas of high technical or commercial losses.
- Despite APERC's directions to the Discoms to complete the study of achievable level of distribution losses by May 2004, the report on the subject from Central Power Research Institute (CPRI) to whom the work was entrusted (7 June 2004) by the Company was still awaited (September 2006).
- The line losses were being worked out by deducting metered sales, assessed sales and agricultural consumption from the total input energy. As agricultural consumption accounts for nearly 30 *per cent* of the total supply, which itself is an estimated figure, line losses cannot be said to be computed on a realistic basis. Evidently energy audit remained incomplete and ineffective.

The Government stated (September 2006) that it was not possible to segregate the total system losses into technical and commercial losses and further in the absence of meters for agricultural services the consumptions in agricultural sector was being estimated nearest to realistic values and the line losses are also nearest to the realistic value.

The reply is not tenable as segregation of total losses into technical and commercial losses as envisaged in the technical hand book of erstwhile APSEB is desirable for controlling the line losses and undue delay in finalisation of the achievable level of distribution losses is unwarranted.

Inadequate internal audit

The internal audit conducted by the management as well as outside agencies was inadequate both in coverage and staff strength

2.2.38 Internal audit is a system designed to ensure proper functioning as well as effectiveness of the internal control system and detection of errors and frauds. The Company has an internal audit department headed by one General Manager who reports to the Director (Finance). The department was conducting internal audit of the Company till 2002-03. Internal audit was outsourced to Chartered Accountant firms from 2003-04 onwards. A review of the internal audit done during the last five years ending 31 March 2005 revealed that:

- Only 30-35 *per cent* of the revenue units due for audit were covered by internal audit.

- Short-assessments of revenue to the extent of 57 *per cent* (Rs. 4.09 crore out of Rs. 7.12 crore) pointed out in internal audit reports for 2000-01 to 2002-03 were pending for settlement (September 2006).

- Similarly 90 *per cent* of short-assessments pointed out for 2003-04 (Rs.1.69 crore out of Rs.1.87 crore) were yet to be realised (September 2006).

- The Statutory auditors in their Report on annual accounts for 2000-01 to 2005-06 commented on inadequate coverage of internal audit and inadequate strength of the internal audit staff.

The Government stated (September 2006) that in order to strengthen the internal audit and its coverage, the job was entrusted to the Chartered Accountant firms with effect from July 2005 and action would be taken to realise the shortfall amounts with close pursuance.

Acknowledgement

Audit acknowledges the co-operation and assistance extended by the staff and the Management of the Company at various stages of conducting the performance audit.

Conclusion

The performance review indicated that billing and collection procedures were deficient as the Company did not apply the tariff rates correctly leading to incorrect billing and resultant loss of revenue, irregular grant of incentives to ineligible HT consumers, payment to e-seva at higher rates for collection of bills, etc. Further, the Company did not adhere to the quota fixed by APERC for drawal and sale of energy to various subsidised categories of consumers leading to substantial revenue loss. The system followed for computation of agricultural consumption was unrealistic. The Company did not have sound and effective energy audit

and internal audit systems. There was improper accounting of sundry debtors.

Recommendations

- ***The Company should evolve a methodology to adhere to the quotas fixed by APERC for drawal/sale of energy and follow the directions of APERC in letter and spirit to plug leakage of revenue.***
- ***The Company should ensure correct billing by following the applicable tariff and proper classification of consumers.***
- ***The Company should make payment to non-urban e-Seva centres at applicable rates only.***
- ***The Company should streamline and strengthen its collection mechanism.***
- ***The Company should evolve a scientific approach for accurate estimation of agricultural consumption.***

2.3 Implementation of Accelerated Power Development Reforms Programme (APDRP) by Power Sector Companies

Highlights

The State Government received Rs.265.10 crore towards incentive for reduction of losses by Discoms, but the same has not been released so far to Discoms in contravention of the conditions of the MoA.

(Paragraph 2.3.12)

The grant amount was released to Discoms as equity by the State Government, in violation of the conditions of the MoA with the result, that three Discoms had to enhance their authorised Share Capital by incurring additional expenditure of 54.65 lakh towards Statutory Fees. Further the funds of Rs.186.17 crore received under the scheme were utilised by four Discoms for purposes other than on schemes under APDRP.

(Paragraph 2.3.13)

EPDCL drew loan of Rs.78.68 crore (March 2004 to March 2006) from PFC (towards counterpart funding), despite having surplus funds ranging from Rs.110.44 crore to Rs.220.40 crore during the period resulting in avoidable payment of interest of Rs. 1.36 crore.

(Paragraphs 2.3.16)

All the four Discoms furnished wrong financial/physical progress to the Distribution Reforms Committee (DRC) and drew excess loans of Rs.180.58 crore from the financial institutions and GOI.

(Paragraphs 2.3.20)

By allowing undue deviations in the scope of work during execution, the company incurred additional expenditure of Rs.64.42 lakh. Payment of different rates for the same work in different contracts resulted in extra expenditure of Rs.53 lakh.

(Paragraphs 2.3.26 and 2.3.27)

Uneconomic procurement of material by Discoms had resulted in avoidable expenditure of Rs 2.71 crore.

(Paragraphs 2.3.30 to 2.3.33 and 2.3.35)

Introduction

2.3.1 The Government of India (GOI) approved the Accelerated Power Development Reforms Programme (APDRP) to leverage the reforms in power sector through the State Governments during the period from May 2002 to March 2007. APDRP is being implemented by the power sector companies through the State Government with the objective of upgradation of sub-transmission and distribution system (33 KV and below) including energy accounting and metering, for which financial support is being provided by the Government of India (GOI). The Ministry of Power (MOP), GOI entered (May, 2002) into a Memorandum of Agreement with the Transmission Corporation of Andhra Pradesh Limited (APTRANSCO), Hyderabad for implementation of APDRP by all the four Distribution Companies[1]. Funds from GOI were to be released to the Companies through the Government of Andhra Pradesh (GOAP). National Thermal Power Corporation Limited (NTPC), the lead adviser-cum-consultants (AcCs) under the overall guidance of MOP, GOI, was to monitor the implementation of the programme in the State. Central Power Research Institute (CPRI), Bangalore was deployed as field AcCs to monitor the implementation of the programme in the power utilities in the State. The programme was to be completed within 18 to 24 months from the date of release (August 2002) of funds from the State Government i.e. by July 2004. The programme was extended up to March 2007 and the schemes were in progress (September 2006).

The Chairman and Managing Director (C&MD) is the Chief Executive of each distribution company (Discom). Implementation of the programme in the respective companies is undertaken by the Director (Projects) who is assisted by Chief General Manager (Projects), General Manager (Projects) and Divisional Engineer Projects (Projects) at Head Office and Superintending Engineer (Operations) and Divisional Engineer (Construction) at field level. Finance wing of the respective companies is headed by Director (Finance) who is assisted by Chief General Manager (Expenditure**)** at Head Office and Sr.Accounts Officer/Asst.Accounts Officer at field level.

Scope of audit

2.3.2 The performance review conducted during August 2005 to March 2006 to evaluate the performance of APDRP during 2002-06 covers the examination of the funds management, material procurement, execution of works, monitoring etc. of the two schemes viz. upgradation of sub-transmission and distribution system scheme and High Voltage Distribution Supply Scheme out of three schemes undertaken by Discoms. The related records/files maintained at respective corporate offices of the four Discoms and APTRANSCO were examined in detail.

[1] Northern Power Distribution Company of AP Limited (NPDCL), Central Power Distribution Company of AP Limited (CPDCL), Southern Power Distribution Company of AP Limited (SPDCL), Eastern Power Distribution Company of AP Limited (EPDCL).

Audit objectives

2.3.3 Performance review of Implementation of APDRP by Power Sector Companies in the State was conducted with a view to ascertain whether

- the schemes were designed with adequate planning keeping in view the experience gained in execution of earlier schemes and projects;
- funding requirements were realistically assessed and funds were sanctioned and released by the GOAP and GOI in time;
- the schemes have been implemented economically, efficiently and effectively;
- the objectives of these schemes as given in Detailed Project Reports (DPRs) have been achieved or not.

Audit criteria

2.3.4 The following Audit criteria were adopted :

- Targets and benchmarks laid down in the Memorandum of Agreement and guidelines issued by MOP, GOI/State Government;
- Terms and conditions of the Loan agreements;
- Projections/Targets set out in Detailed Project Reports;
- Conditions stipulated in various Work orders/files and Contract agreements;

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Audit methodology

2.3.5 The methodology adopted for attaining the audit objectives with reference to audit criteria were examination of:

- Terms and conditions of MOA and guidelines issued by GOI;
- Detailed Project Reports of the Schemes;
- Minutes of DRC, Tenders floated and contracts entered into and Loan agreements with financial institutions;
- MIS Reports furnished to DRC/APTRANSCO by Discoms; and
- Issue of audit queries and interaction with the Management.

Audit findings

2.3.6 Audit findings arising from the performance review were reported to all the four Distribution Companies, APTRANSCO and the State Government in June 2006 and also discussed in the meeting in Audit Review Committee for State Public Sector Enterprises (ARCPSE) held on 26 September 2006 which was attended by the Special Chief Secretary to the Government, Energy Department, Government of Andhra Pradesh and the C&MDs of APTRANSCO and four Discoms. The views expressed by the members in the meeting have been taken into consideration while finalising the review.

The Audit findings are discussed in the succeeding paragraphs.

Funding pattern

2.3.7 GOI's funding under APDRP has the following two components:

- Investment for strengthening and upgradation of the sub-transmission and distribution system, with a view to reducing Transmission and Distribution (T&D) losses;

- Incentive to encourage / motivate utilities to reduce cash losses.

Investment component

2.3.8 The investment component was to be meant for the implementation of the following three schemes with the objective to reduce transmission and distribution (T&D) losses, improve quality/reliability of power supply, revenue collection, customer satisfaction, etc.

- Upgradation of sub-transmission and distribution system in three identified operation circles[*]: i.e. Eluru (EPDCL), Tirupathi (SPDCL) and Warangal (NPDCL) at a cost of Rs.579.69 crore.

- High Voltage Distribution Supply (HVDS) scheme in Central, South and North operation circles of Hyderbabad city and up-gradation of sub-transmission and distribution system (Town Business Plan) in 95 identified towns i.e. 18 in NPDCL, 35 in CPDCL, 22 in SPDCL and 20 in EPDCL at a cost of Rs 843.90 crore.

- Implementation of IT pilot project in four operation circles, one in each Distribution Company at a total cost of Rs.12.90 crore. (Items as specified under this Scheme were procured by the four Discoms. It was, however, decided to utilize these items for their Integrated IT plan. As such Audit could not comment on the implementation of IT Pilot Project).

As per the terms of MOA, fifty *per cent* of the project cost was to be provided by GOI through a combination of grant (25 *per cent*) and loan (25 *per cent*) to

[*] Out of 26 operation circles i.e. NPDCL -5 ; CPDCL-10; EPDCL-5 and SPDCL-6.

the State Government as an additional Plan Assistance. The remaining 50 *per cent* of the project cost was required to be arranged through counterpart funding from Financial Institutions (FIs) i.e. Rural Electrification Corporation (REC) /Power Finance Corporation (PFC) / banks or through internal resources by utilities. GOI withdrew (November 2005) the loan component under central assistance of APDRP after which no further loans were given by GOI under the programme. Loans of Rs.279.25 crore given by GOI before that were paid back fully to GOAP by the Discoms (March 2005).

The following procedure was stipulated by GOI for release of funds to the State Government:

- 25 *per cent* of the GOI portion of assistance to be released upfront on approval of programme and issue of sanction letters by the financial institutions.
- Release of matching funds by the financial institutions.
- After spending 25 *per cent* of the programme cost (i.e. 25 *per cent* GOI plus 25 *per cent* of counterpart fund from FIs), further 50 *per cent* of the GOI amount was to be released.
- Progressive release of the balance 50 *per cent* of the counterpart fund by FIs.
- After spending 75 *per cent* of the programme cost (75 *per cent* GOI + 75 *per cent* of counterpart fund from FIs), balance 25 *per cent* of the GOI amount was to be released.
- Progressive release of the balance 25 *per cent* of the counterpart fund by FIs.

Incentive component

2.3.9 APDRP provided that the State Government would be eligible for incentive up to 50 *per cent* of the actual total T and D loss reduction by the State Electricity Boards/Utilities taking 2000-01 as the base year. The amount of incentive, thus, received was to be allocated to individual power utilities in the ratio of their contribution to the total loss reduction of the enterprise. The grant received under incentive was to be utilised towards improvement in power sector only. The State Government had received Rs.265.10 crore as incentive during the year 2003-04 towards the claim for 2002-03. For the years 2003-04 and 2004-05, incentive claims amounting to Rs.147.23 crore and Rs.174.62 crore respectively have been submitted to the GOI, but have not been paid by GOI so far (September 2006).

Project cost and finance

2.3.10 Clause 7.1(a) of the MOA entered between GOI & APTRANSCO stipulated constitution of a Distribution Reforms Committee (DRC) within one month of signing of MOA. The committee was to comprise Secretary/Energy, GOAP, CMD of APTRANSCO, CMDs of four Discoms, a representative from NTPC or Power Grid Corporation of India Limited and a representative from Central Electricity Authority (CEA) or GOI. The Committee shall meet at least once in three months and review project implementation, compliance to MOA conditions, performance against targets and benchmarks.

The details of the project cost, funds released by GOI, funds mobilised from REC/PFC/Commercial Banks and expenditure incurred (up to March 2006) as reported by the implementing agencies to Distribution Reforms Committee (DRC) are given below;

(Figures Rs. in crore)

Name of the company	Project cost	Funds released by					Cumulative Expenditure	Percentage of Expenditure to the Project cost
		GOI	REC	PFC	Banks	Total		
EPDCL	359.24	70.71	56.90	78.68	70.71	276.99	247.56	68.91
SPDCL	376.67	74.13	147.28	-	74.13	295.54	324.81	86.23
NPDCL	177.15	34.30	78.03	-	34.30	146.63	160.36	90.52
CPDCL	521.81	99.81	86.57	-	99.81	286.19	296.09	56.74
APTRANSCO	1.62	0.30	0.20	-	0.30	0.81	1.57	96.91
Total	1436.49	279.25	368.98	78.68	279.25	1006.16	1030.39	71.73

2.3.11 The general terms and conditions issued by the Government of India, Ministry of Power for utilisation of funds, *inter alia*, include that:

- the State Government shall release the funds provided under APDRP to the State power utility within a week of the said amount being credited in the State Government account by GOI.
- the State Government shall release the funds to the State utility under the same terms and conditions as they receive it from the Central Government.
- the funds received under APDRP shall not be diverted for other purposes either by the State Government or utilities.
- the utilities shall open a separate bank account in the first instance itself in a scheduled/nationalised bank for the purpose of implementing

the Schemes under APDRP. Funds from the Government/ internal resources or loans from FIs earmarked for the purpose shall be credited to this account.

- funds were to be released by GOI as per the procedure stipulated in the MOA.

Audit scrutiny revealed the following:

Non–release of incentive by the State Government

Funds received by the State Government as incentive were not released to Discoms.

2.3.12 The State Government received (March 2004) Rs.265.10 crore from the Government of India towards incentive for reduction of T&D losses by Discoms during the year 2003-04, which was to be released to the power utilities for utilisation in the improvement of power sector only. The same has, however, not been released (September 2006) to Discoms in contravention of the conditions of the MOA.

Release of grant amount as equity by the State Government

Grant amount was released by the State government to Discoms as equity in violation of MOA

2.3.13 The State Government, in violation of the terms and conditions of the MOA and GOI guidelines, released (March 2004) grant amount of Rs.186.17 crore to four Discoms and APTRANSCO as equity. As a result, three[*] out of four Discoms had to enhance their authorised share capital by incurring additional expenditure of Rs.54.65 lakh towards statutory fees.

It was further noticed that the amount (Rs.186.17 crore) was utilised by the four Discoms for payment of dues to APTRANSCO against bulk supply of power to these distribution companies, thus diverting the scheme funds for other purposes.

The Government stated (September 2006) that a policy decision was taken to convert the grant amount as equity to Discoms to strengthen their equity base and to improve credit-worthiness of the Discoms in order to obtain the loans from financial institutions. The reply is not tenable as the release of grant as equity was in violation of MOA conditions.

Non-maintenance of separate bank accounts

2.3.14 Though the utilities had opened separate bank accounts, these accounts were only partially operated except in EPDCL. It was noticed that only GOI funds were credited in these accounts and the funds raised from FIs and expenditure incurred therefrom were not accounted through these accounts. Thus the overall expenditure incurred on APDRP was not susceptible to verification.

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[*] NPDCL,EPDCL and SPDCL

Retention of excess grant

CPDCL retained excess grant of Rs. 28.63 crore

2.3.15 High Voltage Distribution System (HVDS) Scheme to be implemented by CPDCL in Central, South and North operational circles of Hyderabad city was short-closed (September 2004) due to some problems encountered during its implementation. The actual expenditure incurred on the scheme was Rs.106.38 crore (January 2006). The company, however, received an amount of Rs.58.63 crore from GOI towards 25 *per cent* grant for HVDS which was in excess of the eligible amount of grant by Rs.28.63 crore. The excess grant received was not returned to the GOI.

The Government replied (September 2006) that new schemes have been prepared for left over amounts and sent for sanction.

Unwarranted drawl of loan from PFC resulted in avoidable payment of interest

Unwarranted drawal of loan from PFC

2.3.16 EPDCL drew Rs.78.68 crore (March 2004 and March 2006) from PFC (towards counter part funding) at interest rate of 9.5 *per cent* per annum for implementing APDRP in Eluru Model Circle. Audit scrutiny revealed that the company was holding surplus funds ranging between Rs.110.44 crore and Rs.220.40 crore carrying average rate of interest of 7 *per cent* per annum from April 2004 to April 2006. The company had also swapped GOI loans (February / March 2005) by availing loan from commercial banks (7.5 *per cent*) as the rate of interest on GOI loans was higher (11 to 12 *per cent*). Thus, unwarranted drawal of Rs.78.68 crore from PFC resulted in avoidable payment of interest of Rs.1.36 crore.

The Government stated (September 2006) that further funds would not be drawn till the existing funds were utilised.

Excess drawal of loan from PFC and REC

Excess drawal of loan resulted in additional expenditure towards interest

2.3.17 EPDCL had drawn (June 2003 and January 2005) a loan of Rs. 1.93 crore from REC (not under APDRP) for construction of two substations. A contract was entered into with Sri Rajyalakhsmi Cement Products (2003-04) for erection of four substations (including the two substations under APDRP) for Rs.1.81 crore. The Company had also drawn an amount of Rs. 1.60 crore (March 2006) from PFC under counterpart funding for construction of these four substations. Thus there was excess drawal of loan for the two substations both from PFC and REC which resulted in an additional expenditure of Rs. 19.18 lakh towards interest.

The Government stated (September 2006) that there was no double drawal of funds and no additional expenditure, but the problem was missing information only. The reply is not tenable as funds were drawn for two sub-stations both from PFC and REC as per the records produced to Audit.

Non-availing of grant

The utilities have yet to draw the balance grant of Rs. 79.87crore from GOI

2.3.18 As per the guidelines issued for release of funds by GOI, the final 25 *per cent* of the grant amount would be released only after utilities have actually spent 75 *per cent* of the total programme cost. It was noticed by audit that Discoms did not book and report the actual expenditure to DRC. Though 57 *per cent* to 91 *per cent* of the programme cost was reported to have been spent up to March 2006, these figures were based on DPRs and not on actual expenditure. Thus, GOI released only Rs.279.25 crore as against Rs.359.12 crore (25 *per cent* of total grant). This resulted in non-availment of the balance grant of Rs.79.87 crore from GOI.

The Government stated (September 2006) that the APDRP scheme was extended up to March 2007 and the Discoms would draw the balance grant after incurring 75 *per cent* of the project cost. However, as per details furnished to Distribution Reforms Committee, all the Discoms had already incurred more than 75 *per cent* of the project cost.

Implementation of the Programme

2.3.19 Implementation of the three schemes was to be done as per Detailed Project Reports (DPRs) which specify details of targets with respect to each item of work and overall objectives to be achieved. DPRs for the selected model circles were prepared by the Central Power Research Institute (CPRI). Similarly detailed Town Business Plans (TBPs) for 95 towns were prepared by respective Discoms. DPRs and TBPs were approved by the GOI, Ministry of Power.

Deficiencies in execution of works

2.3.20 DPRs of model circles and identified towns of the four Discoms *inter alia* envisaged installation/construction of:

- single (S) –phase and three (3) –phase meters;
- feeder and distribution transformer (DTR) meters;
- construction of substations;
- erection and repairs and maintenance (R&M) of DTRs and
- 33 Kv / 11 Kv / LT lines and Substations, etc.,

Audit scrutiny revealed that all the Discoms furnished wrong financial/ physical progress to DRC and drew excess loans from financial institutions/ GOI which amounted to Rs 61.38 crore (CPDCL), Rs 15.78 crore (NPDCL), Rs 70.24 crore-(SPDCL) and Rs-33.18 crore (EPDCL). The details of DPR provision, funds drawn from GOI and Financial institutions and actual achievements are given in **Annexure 13**.

The Government stated (September 2006) that due to lack of a proper mechanism to track the schemewise expenditure immediately, all the Discoms furnished the expenditure details as per scheme provisions. The fact, however, remains that this situation had arisen due to non-adherence to instructions/guidelines issued for proper operation and maintenance of separate bank accounts.

An examination in audit of execution of various items of works revealed the following:

- Single and three phase meters installed were actually used for replacement of existing working meters instead of replacing the defective and non-working meters by all the four Discoms in violation of the MOA.

The Government stated (September 2006) that the provisions in the scheme were to replace all low quality Electro-mechanical meters for correct recording of consumption and not limited to only stuck-up or defective meters. The reply is not correct as the MOA clearly provided for replacement of stuck-up or defective meters only.

- In CPDCL, the actual number of meters procured (8,02,950) under APDRP was far less than that reported to DRC (10,45,896).

  The Government stated (September 2006) that the purchased quantity (16,18,650) was more than the scheme quantity. The reply is not tenable as it was noticed that the meters procured before implementation of APDRP were also included in the report to DRC.

- In SPDCL and CPDCL, agreements were entered into for lesser quantity than the DPR provision for erection of lines, installation and repairs and maintenance of DTRs.

- In NPDCL, installed quantity of DTR meters was less than the DPR provisions. Different rates were adopted for feeder meters while preparing the DPRs of Town Business Plan (TBP) and Model circle.

- In SPDCL, the quantity of feeder meters reported (278 nos.) to DRC was less than the quantity actually procured (30 nos.). Wrong progress was furnished by SPDCL on installation of DTR meters (1820 nos.) as against the actual installation (478 nos.).

The Government stated (September 2006) that in CPDCL due to urgency in the field some works covered in the schemes were taken up at circle level. No documentary evidence was, however, produced to Audit to substantiate that these works were done under APDRP.

- Works relating to LT line capacitors, meter calibrations and consumer indexing valuing Rs.27.22 crore in SPDCL were not taken up at all. It was, however, noticed that SPDCL furnished physical progress on these works to DRC.

Non achievement of objectives

2.3.21 The successful implementation of the APDRP in the State depended upon the achievement of the following objectives for which physical and financial benchmarks were framed taking 2000-01/2001-02 as the base year.

- Reduction in T&D losses.
- Improving reliability/quality of power supply.
- Increase in revenue.
- Improving customer satisfaction.

The shortfalls in achieving the intended objectives as noticed in audit are discussed in the succeeding paragraphs.

Transmission and Distribution losses

2.3.22 The table below indicates the T&D losses before implementation of APDRP, year-wise targets to be achieved through APDRP as specified in the DPRs and actuals as at the end of 2005-06 in respect of model circles and 95 towns (TBP) of four Discoms:

(In *per cent***)**

Discoms/Circles	**T&D losses**		
	Existing (2001-02)	**Target**	**Actual (2005-06)**
Eluru	18	10	14.81
Warangal	25.6	10	19.36
Tirupathi	24.62	22	20
EPDCL (20 towns)	6.53 to 35.64	10	4.2 to 20.97
CPDCL (34 towns)	4.21 to 22.35	NA	2.58 to 9.96 (2004-05)
NPDCL (18 towns)	8.8 to 46.95	NA	3.11 to 11.29
SPDCL (22 towns)	6.70 to 26	4.6 to 11.9	5.28 to 9.69

The following points were noticed:

- T&D losses could not be reduced to the extent envisaged in their respective DPRs in Eluru and Warangal model circles and in 6 out of 20 towns of EPDCL.
- T&D losses in Tirupathi Model Circle were envisaged to be reduced from 24 *per cent* to 22 *per cent.* The APDRP works were actually

taken up in 2003-04. The actual T& D losses, however, were 20.9 *per cent* and 18.75 *per cent* during the years 2003-04 and 2004-05 respectively indicating unrealistic fixation of targets.

The Government stated (September 2006) that the targets set were based on the data available at that point of time and that it was not always possible to forecast the T&D losses accurately due to several factors such as load growth, increase in network infrastructure, etc. The reply is not tenable as the targets were set taking into consideration all these factors while preparing DPRs.

Quality of supply and Customer satisfaction

2.3.23 To improve reliability and quality of power supplied, outages were to be reduced and failure rate of DTRs was to be brought down by installing 11 KV / 33 KV circuit breakers as well as LT switch capacitors and ensuring regular repairs and maintenance of DTRs.

It was observed by audit that though the quantities of each item to be installed were specified in the DPRs of respective model circles/towns, the installation / fixing of all items was not done as per provisions in the DPR as discussed below:

In Tirupathi model circle:

- As against 66 circuit breakers for 33 KV feeders to be installed as per DPR, only 16 circuit breakers were provided.
- Similarly, as against 7000 LT switched capacitors to be installed, only 1143 LT switched capacitors were installed.
- Feeder outages also could not be reduced to the extent envisaged.

The Government stated (September 2006) that the feeder trippings were reduced from 126536 nos in 2002-03 to 97163 nos. in 2005-06, which was a significant achievement in the face of increasing 11 KV feeders. The reply is not tenable as the target was to reduce the trippings to 21 nos., which was not achieved by the Discom.

- In Warangal model circle, as against the target of reducing feeder outages to 50 numbers, 3179 feeder outages were recorded in 2005-06.
- In all the 22 towns of SPDCL (under Town Business Plan), feeder outages were ranging from 48 to 3660 as against the target of 12 to 420.
- In 23 out of 52 towns of EPDCL, SPDCL and NPDCL, DTR failure rates were much higher than the targets.

The Government stated (September 2006) that the higher DTR failure rate in EPDCL was due to cyclonic conditions during the year 2005-06. In respect of NPDCL it was stated that the DTR failure was more than the set target in seven out of 18 towns due to non-implementation of proposed works as contemplated in APDRP.

- Consumer satisfaction is indicated by reduction in the number of complaints. In Tirupati Model circle, there was only 13 *per cent* reduction in consumer complaints as against a target of 50 *per cent* and in Warangal model circle the reduction was 70 *per cent* as against a target of 85 *per cent*.

Revenue Collections

2.3.24 With a view to improve the revenue collection, targets were fixed for bridging the gap between Average Revenue Realisation (ARR) and Average Cost of Supply (ACS); input energy vis–a-vis metered energy; collection efficiency and billing efficiency.

The following points were noticed in audit:

- As against a target of bringing the gap between ARR and ACS to 'nil', the gap was 9 paise in Warangal circle and 18 paise in Tirupathi circle.

- Warangal, Tirupathi and Eluru Circles could achieve only 33.37 *per cent*, 46 *per cent* and 60.50 *per cent* of input vis-a-vis metered energy as against the target of 90 *per cent*, 78 *per cent* and 70 *per cent* respectively.

The Government stated (September 2006) that as per DPR of Warangal model circle, target was set considering input energy exclusive of unmetered sales. The reply is not tenable as the input energy should include both metered and un-metered sales.

- Nine out of 22 towns (TBP) of SPDCL could not achieve the set targets for input vis-a-vis metered energy as the targets were unrealistic.

- Target of 100 *per cent* billing efficiency was not achieved by 25 out of 40 towns of SPDCL and NPDCL.

- As against the envisaged monthly billing system, bimonthly billing system was still being continued in rural areas in all the four Discoms.

Execution of contracts

2.3.25 For execution of APDRP, Discoms entered into various contracts for the construction of 33/11 KV substations, erection of DTRs, feeder meters repairs and maintenance of substations and DTRs erection and reconductoring of 33/11 KV/ LT lines etc. The following deficiencies were observed by Audit in tender analysis and execution of works:

Loss in execution of works

Improper estimation and survey before awarding the work resulted in additional expenditure of Rs.64.42 lakh

2.3.26 NPDCL invited three bids (May 2004) for erection of 33 KV/ 11 KV lines, reconductoring of 33 KV/11 KV and LT lines, etc., in Warangal town, Mahabubabad and Mulugu Divisions of Warangal district, Karimnagar district and Khammam districts of Warangal Zone. Works to be executed under each area were specified and tenderers were required to quote rates for each individual specified item. After technical and financial bid evaluation, the Company awarded (September 2004) all the three works to a contractor who was the lowest (L1) on overall comparison on semi turnkey basis at a cost of Rs.2.76 crore. While the works were in progress, the Company approved deviations (from February 2005 to December 2005) in the works by including additional quantities and deleting certain items of works altogether. Due to deviations the total cost of the three works was revised to Rs. 4.04 crore.

The following points were noticed in audit:

- The Company finalised the contract without proper field survey and work estimate as was evident from the fact of cancellation of certain items of work altogether and increase in quantum of certain items of work by more than 20 times

- Due to cancellation/addition of certain items of work, the contractor had no longer remained the lowest on overall basis.

- In the deviations approved, lowest quoted items of work were found to have been cancelled whereas highest quoted items of work were increased abnormally.

- The Company failed to make proper estimation and survey before awarding the contract or negotiating with the contractor to come at par with the lowest offer. The additional expenditure in all the three contracts worked out to Rs.64.42 lakh; being the difference in rates on additional quantities compared with the rates offered by other contractors.

The Government stated (September 2006) that the disparity was due to time gap of three years between survey and actual field execution and the deviations were necessitated due to field conditions during the execution of work and the work was awarded as per tendering rules and the lowest quoted open tender was taken into consideration. The reply is not tenable, as the company should have conducted proper survey before taking up the work and negotiated with the contractor to accept the lowest rates of items offered by the other contractor.

Payment of different rates for the same work in the same circle in different contracts

Payment of different rates for similar nature of work in two different contracts resulted in excess payment of Rs.53 lakh

2.3.27 NPDCL awarded (12 march 2004) two separate works for conversion of low voltage distribution system (LVDS) to high voltage distribution system (HVDS) in two divisions of Warangal Model circle to a contractor. Though the works involved were of similar nature, the contractor quoted different rates for same items of works in some cases. The difference in rates ranged between Rs.2 and Rs.2520. The company accepted the rates quoted by the contractor without making negotiations for acceptance of the lower rates quoted by the contractor. This resulted in extra expenditure of Rs.53 lakh.

The Government stated (September 2006) that the rates for major materials like 8M PSCC poles, line stringing, DTR erection and distribution boxes, etc are the same in both the agreements but the quantities are different in these two agreements and hence the total amounts would be different in both the agreements. The reply is not acceptable as the difference has been worked out in audit after considering quantities and rates in both the contracts.

Interest loss on excess payments made to a contractor

2.3.28 SPDCL awarded (28 January 2003) the work of conversion of Low Voltage Distribution System to High Voltage Distribution System in Madanapally of Tirupathi model circle to a firm at a cost of Rs 74.67 crore. The Company, after one year, noticed (August 2005) an excess drawal to the extent of Rs. 1.79 crore by the firm while processing the final bill. The excess payment was recovered from the firm subsequently.

Audit scrutiny revealed the following:

Delay in adjustment of excess payment made resulted in loss of interest Rs.35.58 lakh

- Supply and erection of 1745 PSCC poles (8 Mts) were claimed in excess and bill was also passed for payment.
- Claims were preferred and passed for erection of 30638 cross arms as against 7599 actually erected.
- As against 63 of top fittings and insulators actually erected, claims were allowed for 8483.
- These bills were passed after check measurement and were certified by the Assistant Divisional Engineer/Divisional Engineer of construction wing indicating deficiency in the internal control system and lack of monitoring.
- Due to delay in adjustment of excess payments made, the Company suffered interest loss of Rs. 35.58 lakh at interest rate of 8.5 *per cent* i.e. the rate at which the company was borrowing the funds.

The Government stated (September 2006) that the Discom was pursuing the matter with the firm for payment of interest. The reply is not tenable as in the absence of any clause in the agreement, recovery of interest from the contractor would not be possible.

Procurement of materials

2.3.29 All the Discoms procured various items viz., meters, and cables, DTRs etc., under APDRP. Audit scrutiny of cases of procurement of meters (single and three phase) and other equipment revealed the following deficiencies:

Avoidable expenditure on purchase of single phase meters

Procurement of higher rating meters in lieu of lower rating meters resulted in avoidable expenditure of Rs.69.56 lakh

2.3.30 SPDCL decided to procure four lakh single-phase electro static energy meters of 10-60A capacity with 1.0 accuracy and initially placed order (24 May 2003) for one lakh meters on the lowest quoted tenderer at the rate of Rs. 550 per meter (inclusive of all taxes). As the performance of these meters as supplied by the firm was found to be unsatisfactory, the Company made enquiries (20 October 2003) from other Discoms about 5-20 A capacity meters which would also serve the same purpose and found that the same were available with CPDCL at the rate of Rs.513. The Company, however, placed orders (29 October 2003) for the balance three lakh meters of 10.60A capacity at Rs.550 per meter on the same firm.

The following points were noticed:

- Procurement of meters of 10-60A capacity at the rate of Rs. 550 lacked justification, when the 5-20A capacity meters at the rate of Rs.513 would have served the same purpose. This resulted in avoidable expenditure of Rs. 69.56 lakh.

- Placing orders for rest of the three lakh meters on the same firm despite being aware of the substandard quality of meters already supplied resulted in procurement of substandard meters.

2.3.31 It was further noticed that out of four lakh meters procured, SPDCL diverted 50,000 meters (8 December 2003 - 19 April 2004) and 62,000 meters (30 August 2003 - 16 April 2004) to NPDCL and CPDCL respectively on their request.

Diversion of meters resulted in avoidable expenditure of Rs.18 lakh

NPDCL paid the cost of 50000 meters directly to the supplier. On SPDCL's request for return of these meters, NPDCL placed a purchase order (30 October 2004) at Rs.549 per meter on a firm and directed the firm to supply the meters directly to SPDCL. SPDCL accepted and paid the cost of meters directly to the supplier.

It was noticed in audit that the said firm had earlier been rejected by SPDCL (7 April 2004) on the ground that the meters supplied by the firm failed during tests. It was further observed that SPDCL, in the meanwhile had procured 5-20 A capacity meters at the rate of Rs. 513 which served the same purpose. Thus, the entire exercise of getting back 50000 meters from NPDCL instead of procuring 5-20A capacity meters at the rate of Rs.513 per meter resulted in avoidable expenditure of Rs. 18 lakh.

The Government stated (September 2006) that the difference was due to procurement of higher capacity meters and the loss sustained through non-provision of meters in the field was more than that of the services left without connections of meters. The reply is not tenable as there was no need to procure higher capacity meters when 5-20 A meters would have been sufficient for domestic use. Further, the contention that loss would be more if services are left without meters by SPDCL was also not correct as NPDC supplied meters after one year and that too when the prices of meters showed a downward trend.

Due to delay in settlement of cost of meters, SPDCL suffered an interst loss of Rs. 83.12 lakh

2.3.32 CPDCL was to return 62000 meters taken from SPDCL as the latter had paid the cost to the supplier. CPDCL expressed its inability to return the meters and agreed to pay the cost of meters (October 2004). SPDCL, after a delay of one year preferred a claim (November 2005) on CPDCL including sales tax at the rate of 12 *per cent* raising the cost per meter to Rs. 616. CPDCL accepted the claim and asked SPDCL to raise the bill directly on circle stores for payment. SPDCL is yet to raise the bill on circle stores (March 2006).

The following points were noticed in audit:

- Because of inordinate delay in taking decisions both by SPDCL and CPDCL, CPDCL was forced to accept the increased cost of meters (including sales tax at the rate of 12 *per cent*) resulting in avoidable expenditure of Rs.40.92 lakh.

- SPDCL had procured the meters out of loan funds from REC and GOI at interest rate of 9.75 *per cent* under APDRP. Diversion and delay resulted in locking up of funds amounting to Rs.3.41 crore and an interest loss of Rs.83.12 lakh from April 2004 to September 2006.

The Government stated (September 2006) that CPDCL would pay the cost of 62000 meters to SPDCL including sales tax. In the ARCPSE meeting the management of CPDCL stated that it would replace the meters to avoid sales tax. The fact, however, remains that SPDCL was put to loss even if meters were replaced due to downward trend in prices of meters.

Avoidable payment of Value Added Tax on delayed supplies

Payment of VAT on delayed supplies resulted in avoidable expenditure of Rs.37.88 lakh

2.3.33 SPDCL placed a repeat order (01 January 2005) for procurement of 197340 S-phase electro static meters at the rate of Rs. 488 per meter (inclusive of all taxes) to be supplied by 31 May 2005. As per the terms of the purchase order, in case delivery schedule was not adhered to by the supplier and if statutory levies increased during the extended period, the supplier would bear the impact of the increase. The firm requested for enhancement of prices on the supplies to be made on or after 1April 2005 on account of introduction of Value Added Tax. Meanwhile the Company placed an order (16 July 2005) on another firm for procurement of the same type of meters at the rate of Rs.

478 per meter (inclusive of all taxes). Though 97340 meters were not supplied within the delivery schedule (31 May 2005), the Company accepted (12 October 2005) the request of the firm for payment of VAT on the entire quantity supplied on or after 1 April 2005.

Thus payment of VAT on the supply of 97340 meters beyond the delivery schedule amounted to extension of undue favour to the supplier and resulted in avoidable expenditure of Rs. 37.88 lakh as the Company could have stopped further supplies from the supplier, more so in view of the subsequent order of 16 July 2005 which was placed at Rs.478 per meter (inclusive of all taxes).

The Government stated (September 2006) that meters were procured due to urgency and by paying the VAT in the interest of the organisation as processing and procurement of meter would take not less than six months. The reply is not tenable as subsequent order was placed in July 2005 itself at lesser price and before the completion of supplies.

Procurement of defective transformers

The company accepted defective DTRs worth Rs.31.16 lakh despite rejection by third party.

2.3.34 SPDCL placed (11 April 2005) a purchase order for procurement of 200 numbers of 16 KVA pole mounted distribution transformers on a firm price of Rs.31163 (inclusive of all taxes). As per the terms and conditions of the purchase order, despatches were to be made only after inspection by the Company or their authorized inspecting agent. The first lot of 100 transformers offered for inspection by the firm was rejected (March 2005) by RITES (authorized inspecting agency) due to some defects noticed during inspection. The firm, without rectifying the defects, again offered the same transformers for inspection which were again rejected (11 April 2005) by RITES. Without waiting for despatch instructions, the firm supplied 100 transformers which were accepted (April 2005) and utilised by the Company resulting in procurement and utilisation of defective transformers valuing Rs.31.16 lakh. The second lot of 100 transformers was also rejected by RITES during inspection and the Company cancelled the order.

The Government replied (September 2006) that transformers were accepted in view of urgency in the field. The fact, however, remains that defective transformers were accepted without regard to the negative report of the RITES.

Additional expenditure on procurement of meters

Non cancellation of purchase orders in case of non adherence to delivery schedule and rejection of meters in two consecutive consignments resulted in avoidable expenditure

2.3.35 EPDCL placed a purchase order (07 February 2004) for procurement of S-phase electronic energy meters of class 1.0 accuracy on HPL SOCOMEC Ltd (firm –A) for 2,10,000 meters and on TTL Ltd (firm-B) for 90,000 meters at the rate of Rs. 513 per meter with delivery schedule commencing from April 2004 at the rate of 30,000 meters per month. Delivery was to be completed by October 2004. As per the terms and conditions of the purchase order, the Company, in the event of non-adherence to the delivery schedule by the suppliers, had the right (Clause 14) to cancel the contract, forfeit the deposit and recover damages for breach of contract. The Company had also the right to cancel the order (Clause 4 (2)) if the tests on meters failed in two consecutive consignments. It was observed in audit that the firms did not adhere to the delivery schedule and actual supplies were made by firm-A from August 2004 to May 2005 and by firm-B from September 2004 to December 2005. When the supplies were still in progress, the Company floated another tender (June 2004) for procurement of 3,00,000 S-phase meters and placed purchase order (9 February 2005) on firm A for 2,70,000 meters at the rate of Rs.498.59 per meter. The firm supplied 90,000 meters after the issue of the second purchase order.

Audit scrutiny revealed the following:

- As firm-A agreed to supply meters at the rate of Rs 498.59 per meter in the second purchase order and it did not adhere to the delivery schedule of the first purchase order, the Company should have either cancelled the balance 90,000 meters in terms of purchase order conditions or insisted on supply of meters at the rate agreed to in the second purchase order. Accepting the balance quantity of the first purchase order at a cost more than that agreed to in the second purchase order resulted in avoidable expenditure of Rs.12.97 lakh.
- Though the second and third lots offered for inspection by firm-B were rejected on inspection, the firm was allowed to supply 60,000 meters from May to December 2005. Cancellation of the balance quantity and placing fresh order at the available lower rate of Rs.498.59 per meter would have resulted in incurring of less expenditure to the extent of Rs. 8.65 lakh.

The Government stated (September 2006) that the firm was allowed to supply the meters in order to avoid dislocation of work in release of services and resultant revenue loss to EPDCL, as the fresh procurement process would have taken again a period of 5 to 6 months. The reply is not tenable as delivery schedule against the first order was not adhered to by both the firms and the company had the option of foreclosing the contract and procuring the meters at lower rates which was not resorted to.

Acknowledgement

Audit acknowledges the co-operation and assistance extended by the staff and the Management of the Company at various stages of conducting the performance audit.

Conclusion

The Power Distribution Companies failed to comply with the guidelines issued by the GOI, Ministry of Power for utilisation of funds and drew excess funds from the Government of India/REC for execution of schemes under APDRP. At the Detailed Project Report preparation stage unrealistic/wrong targets were set and later on wrong physical and financial progress reports were furnished to the Distribution Reforms Committee/AP TRANSCO. Materials were procured uneconomically and of substandard quality. Bills were passed without verifying the genuiness

of claims indicating deficient internal control and lack of proper monitoring. There were shortfalls in achievements of targets by all the Discoms as a result of which individual scheme objectives and the overall objective of 'Upgradation of Sub-transmission and Distribution System including energy accounting and metering' could not be achieved as envisaged.

Recommendations

- ***Timeliness in Implementation of projects should be ensured by enhancing the quality of monitoring and control. Review of the schemes should be undertaken regularly to identify slippage in the schedule, reasons therefor and remedial follow up action should be taken***

- ***Discoms should exercise greater financial discipline and should ensure compliance with terms and conditions of funding.***

- ***Discoms should consider putting in place a system to ensure better coordination and exchange of information on common items of procurement to achieve optimal economy in procurements.***

2.4 Andhra Pradesh State Financial Corporation and Andhra Pradesh Industrial Development Corporation Limited

INTERNAL CONTROL SYSTEM IN STATE FINANCIAL SECTOR UNDERTAKINGS

Highlights

Business plan and resource forecasting was not finalised before commencement of the financial year in APSFC. The reasons for variations in achievements were not analysed by both the corporations.

(Paragraphs:2.4.7 and 2.4.8)

Audit Committee was not constituted in APIDC. In APSFC, Audit Committee did not discuss certain operational aspects falling under its scope.

(Paragraph:2.4.9)

Internal Audit does not exist in APIDC. In APSFC, internal audit covers only routine areas and does not examine important areas like non-performing assets, seizure of assets, missing units valuation procedures of securities, etc. and compliance to its observations was very slow.

(Paragraph:2.4.10)

There were deficiencies in the Internal control system in both the organisations relating to appraisal, sanction, disbursement, monitoring, demand and recovery of loans.

(Paragraphs:2.4.14 to 2.4.20)

Inadequate monitoring and non-existence of adequate recovery mechanism in APSFC and APIDC led to accumulation of non-performing assets.

(Paragraphs:2.4.23 and 2.4.24)

APIDC did not enforce buy back undertaking effectively for disinvestment and funds amounting to Rs.51.73 crore were not available for recycling.

(Paragraph:2.4.27)

APIDC extended One Time Settlement benefit to defaulted units indiscriminately flouting its own guidelines. This resulted in foregoing an amount of Rs.14.36 crore.

(Paragraph:2.4.31)

Introduction

2.4.1 Internal Control is an integral part of the process designed and put in place by the management of an organisation to achieve its specified objectives effectively, economically and efficiently. It helps in creating a reliable financial and management information system besides facilitating effective decision making. Internal Control System is most effective when it is built into the entity's infrastructure and is an integral part of the essence of the organisation. Internal control in Government financial institutions assumes greater significance in view of the fact that they deal with public money and therefore these institutions have to transact business in such a manner that the risk of default by the borrowers is reduced to the minimum.

There are two Government Companies* and one Statutory Corporation (Andhra Pradesh State Financial Corporation – APSFC) in the financial sector. One of the two Government Companies (APIDC) and the Statutory Corporation were selected for performance review.

Andhra Pradesh State Financial Corporation (APSFC) was set up in November 1956 under the State Financial Corporations (SFCs) Act, 1951 with the objective of catering to the financial needs of tiny, small and medium scale industries and service enterprises. The Corporation extends financial assistance for acquisition of fixed assets, working capital loans and seed capital loans. The Corporation is also engaged in distribution of general insurance policies and sale of Government of India relief bonds.

Andhra Pradesh Industrial Development Corporation Limited (APIDC) was incorporated in 1960 as a wholly owned Government Company under the Companies Act, 1956 with the objective to plan, formulate and execute projects for setting up of industries or developing lines of production and to promote, improve and develop industries in the State. The activities of the Company are mainly participation in equity capital, providing term loans, offering bill discounting facility and venture capital funding.

A sectoral review on One Time Settlement scheme (OTS) in APSFC was included in the Report of Comptroller and Auditor General of India for the year ended 31 March 2003 (Commercial) – Government of Andhra Pradesh. The recommendations of Committee on Public Undertakings (COPU) contained in their 11th Report were presented to the State Legislature on 28 March 2006. Action Taken Notes thereon from the State Government are still awaited (September 2006).

The working of APIDC was also reviewed and included in the Report of Comptroller and Auditor General of India for the year ended 31 March 2001 (Commercial) – Government of Andhra Pradesh.

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* Andhra Pradesh Industrial Development Corporation Limited (APIDC) and Andhra Pradesh State Film, Television and Theatre Development Corporation Limited.

Scope of audit

2.4.2 The present performance review conducted during January to May 2006 examines the mechanism of internal control and internal audit prevalent in these two organisations (APSFC and APIDC) during 2001-02 to 2005-06.

In respect of APSFC the activities relating to the head office and eight branches out of 25 branches were reviewed and 77 cases (out of 643) of loan sanctioned to the extent of Rs.50 lakh and above were examined. In respect of APIDC, 59 out of 190 cases relating to term loans, bill discounting, investment, disinvestments and one time settlement scheme were examined.

Audit objectives

2.4.3 Performance review of internal controls in respect of activities in APSFC and APIDC was conducted with a view to assess whether:

- the budget prepared served as a tool of financial control.;
- proper internal control systems particularly covering lending activities had been evolved and were functioning effectively in these institutions;
- the control systems are adequate and effective in matters relating to loan cases with reference to appraisal and sanctions, disbursement and monitoring, demand and recovery, management of Non Performing Assets (NPAs) and other related activities;
- internal audit was conducted as per guidelines formulated and its coverage was adequate and commensurate with the size and activities of the institutions.

Audit criteria

2.4.4 The audit criteria considered for assessing the achievement of audit objectives were as follows:

- Targets set out in the Business plan and Resource forecasts and Budget Estimates;
- Provisions of Functional/Operational Manuals and Vigilance operational guidelines;
- Targets and benchmarks laid down in the Memorandum of Understanding entered into with SIDBI and the State Government;

- Guidelines and norms issued by RBI/SIDBI and
- Orders/instructions issued by the State Government.

Audit methodology

2.4.5 The audit methodology adopted for attaining the audit objectives with reference to audit criteria was examination of;

- Project information sheets, memoranda put up to the loan sanctioning authority, agenda and minutes of Board of Directors meetings, correspondence with the loanees, office orders issued from time to time by the Head Office, the general, special and additional conditions applicable to sanctions of loans along with other relevant papers available, asset files and legal files;
- Data collected and evidence gathered from the records apart from unit master sheets generated from the database maintained at the branches;
- Internal Audit Reports, Statutory auditors' Reports and Annual accounts; and
- Issue of audit enquiries and interaction with the management.

Audit findings

2.4.6 Audit findings arising from the performance review on internal control and internal audit prevalent in APSFC and APIDC were reported to the respective organisation and the Government in June 2006 and discussed in the meeting of Audit Review Committee for State Public Sector Enterprises (ARCPSE) held on 27 September 2006 which was attended by the Joint Secretary to the Government, Industries and Commerce Department, Government of Andhra Pradesh and the Vice Chairman and Managing Director, APIDC and Managing Director, APSFC. The views expressed by the members have been taken into consideration while finalising the review.

Audit findings are discussed in the succeeding paragraphs.

Internal Control Tools

Budgetary Control

2.4.7 Budget is a quantitative financial expression of a programme of measures planned for a given period. The Budget is drawn up with a view to plan future operations and to make *ex-post facto* checks on the results obtained. Timely preparation of budget and analysis of the variations noticed with reference to the actual execution serve to strengthen internal control by indicating gaps and lacunae in financial planning.

2.4.8 APSFC and APIDC prepared Annual Revenue Budgets for each financial year. Besides, APSFC prepared Business Plan and Resource Forecasting (BPRF) annually for submission to Small Industries Development Bank of India (SIDBI) for approval based on which it borrowed funds from financial institutions, banks and through fixed deposits depending on requirements. Both the organisations did not prepare Corporate Plans. APIDC also prepare BPRF annually for internal control purposes. The following deficiencies in regard to preparation and analysis of budget were noticed:

APSFC

Delay ranging from four to ten months was noticed in approval of BPRF by the Board

- The Corporation did not finalise the BPRF well before the commencement of the financial year and, as a result, approvals of the Board were obtained with delays ranging from four to ten months during the five years ended 2005-06. As a result, the receipt of finance from SIDBI got delayed, leading to less disbursements during the first and second quarters.

- There were delays in finalisation of branch-wise targets ranging from one to three months. The branch-wise targets were not fixed taking into consideration the sector-wise targets and instead lump sum targets were fixed for the branches. It was noticed in audit that SIDBI conducted mid-term reviews for the years 2003-04 and 2004-05 and due to low performance of the corporation reduced the targets and also decreased the quantum of refinance made at concessional rates for 2003-04 from Rs.125 crore to Rs.100 crore.

Remedial measures were not taken to reduce the administrative and establishment expenditure as stipulated in MOU

- As per the Memorandum of Understanding (MOU) entered into (November 2003) with SIDBI and the State Government for restructuring with a view to improve the performance of the Corporation, the Corporation was required to reduce the administrative and establishment expenditure in a phased manner to 10 *per cent* of total income over a period of five years. It was, however, observed by audit that the percentage of actual expenditure to total income increased from 14.06 (2003-04) to 17.57 (2005-06). Further, while working out the budget proposals, the Corporation did not take care either to reduce the expenditure or to initiate measures to increase the income so as to keep the expenditure within ten *per cent* as stipulated in MOU.

APIDC

Targets fixed were not realistic and the variances noticed were not analysed for taking remedial measures

- The targets fixed were not realistic and the reasons for variance were not analysed for taking remedial measures. Targets fixed year after year were not on the basis of achievements of previous years.

- Shortfall in actual as compared to the budgeted figures were noticed in respect of items like disbursement of term loans (from 49 to 75 *per cent*), recovery of term loans (from 40 to 72 *per cent*) and disinvestments of equity (from 70 to 96 *per cent*) in the five years ending 31 March 2006.

- The BPRF for the year 2003-04 was not prepared by the Company and as such no targets were fixed.

- The approval of the Board of Directors for BPRF for 2001-02 and 2004-05 was obtained after delay of ten and eight months respectively.

Thus, the budget was prepared each year by both the organizations as a routine document and did not serve as a tool of internal control.

Audit Committee

2.4.9 The Audit Committee (AC) is useful for reviewing the internal control system and also the accounting policies, cost reduction methods, general policy, procedural aspects with regard to collateral security and half yearly and annual financial statements before submission to the Board and to ensure their compliance.

Audit Committee did not discuss aspects falling under its scope.

It was noticed in audit that:

- AC constituted (December 2001) in APSFC did not function due to frequent changes in the constitution of the Board. The AC constituted again in April 2005 has not discussed so far (August 2006) certain important operational aspects falling under its scope such as review of accounting policies, interest concessions, cost reduction measures, review of general policy and procedural aspects with regard to collateral security.

Audit Committee was not constituted by APIDC.

- As per paragraph 9A of the non-banking finance Companies prudential norms (Reserve Bank) directions, 1998, any Non-banking Financial Company (NBFC) having assets of Rs.50 crore and more is required to form an audit committee. APIDC is registered as NBFC with assets of more than Rs.50 crore. APIDC has not constituted the Audit Committee so far on the plea that even though it is registered as NBFC, it being a Government Company under Section 617 of Companies Act 1956, the RBI's prudential norms were not applicable.

  The role of the AC, however, is vital especially in the company where huge investment of the Government is at stake and independent directors are in majority. In the absence of AC, the Management of APIDC was deprived of reviewing the company's financial and risk management policies and adequacy of internal control systems.

Internal Audit

APIDC neither established Internal Audit Department nor conducted the audit by engaging outside agencies

2.4.10 Internal Audit (IA) is an appraisal of the activities of an entity as a service to the entity. Its functions, *inter alia*, include examination, evaluation and monitoring of the adequacy and effectiveness of the accounting and internal control system. APIDC neither has any internal audit department (IAD) of its own nor is there any system to get the IA done through outside agencies. APSFC, however, established IAD in the corporation in 1997-98. The following deficiencies were noticed in the working of IAD in APSFC:

Deficiencies were noticed in the functioning of Internal Audit Department of APSFC

- Details of audit conducted, observations made, audits planned etc were available only from 2003-04 onwards.
- Out of 8502 observations raised during audit of all 25 Branch Offices during the three years ended 31 March 2006, only 2066 observations (24 *per cent*) were attended to and the balance were pending compliance (September 2006).
- Head office transactions were not covered by IA.
- Review of IA reports revealed that observations were of general nature only and issues like non performing assets, seizure of assets, loss assets, missing units, valuation procedures of collateral security, etc., were not examined.
- Suggestions of the Audit Committee on systems and procedures to be followed in IAD like conducting special audits in selected areas viz., review of shadow account, one time settlement, interest concessions, seizure cases and covering the transactions of Head office etc. were pending compliance.

The Internal Audit system in APSFC, thus, did not serve as an effective tool of internal control.

Vigilance mechanism

2.4.11 APIDC has no vigilance department**.** APSFC established (July 1999) a Vigilance Department in the Corporation to handle complaints received against officers and staff of the Corporation and to undertake tasks such as in-depth checking of sanctions, disbursements and seized units, checking of debit vouchers, etc., and reporting deviations to the Managing Director and prescribing procedure for dealing with such cases. Vigilance operational guidelines were, however, prepared only in August 2004, which came into effect from July 2005 after approval of Andhra Pradesh Vigilance Commission (APVC). Vigilance Department in the Corporation is headed by an Assistant General Manager.

The following deficiencies were noticed in the working of the Vigilance Department:

Vigilance Department was merged with Internal Audit Department defeating the very purpose of its constitution

- As per operational guidelines, the Vigilance Officer (VO) shall be nominated/appointed with the concurrence of APVC. Such concurrence of APVC was, however, not obtained for appointment of the VO. Further, the Vigilance Department should have been headed by a person other than the employee of the Corporation to discharge the duties without fear and favour.

- Head office transactions were not covered by the Vigilance Department though the operational guidelines stipulated such coverage.

- During the five years ended 31 March 2006, only 44 cases of minor nature referred to the vigilance department were investigated. No cases of fraud/misappropriation were noticed by the department.

- The Vigilance Department was merged (May 2006) with the Internal Audit Department without any justifiable reasons and that, too, without the approval of the Board, thus, defeating the very purpose of constitution of the Vigilance Department.

The Management stated (September 2006) that Head Office transactions were also now being covered by the Vigilance Department/Internal Audit.

Non-adherence to Office Orders issued by APSFC and suggestions of SIDBI

2.4.12 In respect of APSFC, the following points were noticed in audit:

- Maintenance of note file system is essential for complete information of a particular subject/activity to be available in one file. This ensures transparency of the action taken/proposed to be taken to facilitate smooth functioning and decision making at various levels of the hierarchy of an organisation despite change of personnel of a particular activity and guards against deviations of set procedures/guidelines so that legal problems at a later stage are obviated. It was observed that though detailed guidelines were issued in APSFC in June 2001 for maintenance of note file system, and the instructions were reiterated in July 2002 and April 2005, the instructions were not being followed either in the Head office or in Branch offices.

The Management stated (September 2006) that due to practical problems, the note file system was dispensed with. The reply is not tenable as the system itself was not followed and the advantages of the note file system were not derived.

- In its performance evaluation study report, SIDBI suggested (July 2004) that it be made mandatory for assisted units to insure their assets jointly with APSFC with comprehensive risk cover so as to ensure renewal of the policy through out the tenure of the loan period. It was observed that despite the directions (January 2005) of the

Board of Directors for its implementation, insurance policies were not being taken jointly rendering the Corporation vulnerable to loss in case of peril.

The Management stated (September 2006) that the policies were hypothecated in favour of the Corporation. The reply is not tenable as hypothecation of policies would not ensure renewal of the policies.

Internal Control in major activities

2.4.13 The lending functions involve the following three major activities:

- Appraisal and Sanction.
- Disbursement and monitoring.
- Demand and Recovery.

The deficiencies in the Internal control procedures in respect of these functions are discussed in the succeeding paragraphs.

Term Loans

Appraisal and Sanction

2.4.14 Appraisal is a critical examination of technical, financial and commercial feasibility of a project and of the managerial competence of promoters to implement and run the project successfully. Appraisal of projects is necessary to determine the possibility of optimal returns from investments in those projects. The quality of appraisal depends on the degree of accuracy of basic estimates of the project.

APSFC

2.4.15 Some of the deficiencies noticed in the appraisal of 77 cases scrutinised by Audit are tabulated below:

Sl.No.	Nature of deficiency in appraisal system	Number of cases in which deficiency was noticed
1	Improper technical/commercial/marketing appraisal of the projections of assisted units	21
2	Promoters background/track record not evaluated properly	9
3	Creditworthiness of applicant not ascertained from banks/financial institutions	5
4	Conditions not complied with (Escrow Account etc)	11
5	Appraisals without adequate supporting documents	11
6	Sanction of term loan beyond schematic provisions	4
7	Strength, Weakness, Opportunities, Threat (SWOT) analysis not done.	3
8	Pre-sanction inspection was inadequate	4

Deviations from approved guidelines were noticed in the Appraisal System of APSFC.

It was, therefore, evident that the appraisal system in the Corporation was not effective and needs improvement.

The Management stated (September 2006) that the guidelines framed are relaxable keeping in view ground realities for implementation of the projects. The reply is not acceptable as the guidelines are required to be followed to have effective control and to ensure transparency.

Disbursement and monitoring of term loans

Loan disbursement

APSFC

2.4.16 The following deficiencies were noticed in disbursement of loans in 58 cases out of 77 cases scrutinised by audit:

Sl.No.	Nature of deficiency	Number of cases of deficiency*
1	Non fulfilment of terms and conditions of sanction before first disbursement	19
2	Relaxation of terms and conditions of sanction in creation of security	33
3	Deviations from approved plan	6
4	Release of further instalments despite non-adherence to the project implementation schedule	10
5	Non verification of audited accounts during implementation	6
6	Inadequacy of promoter's capital	14
7	Non insurance of primary assets	17
8	Non exhibition of Display Board indicating finance projected by APSFC	16
9	Creation of Charge not filed with Registrar of Companies	10
10	Statutory clearance not obtained	16
11	Non submission of required documents	3
12	Disbursement despite default	3
13	Financing cost overruns contrary to conditions of sanctions	3

* Some of the cases, appearing against more than one deficiency since various deficiencies were noticed in such cases.

The Management stated (September 2006) that the conditions of sanctions were relaxed depending upon the need of the business. It further stated that these conditions were evolved by the Corporation and not prescribed by the Government/SIDBI. The reply is not acceptable as guidelines are framed to have effective control and for transparency.

Deficiencies in loan disbursement were noticed in cases of term loans sanctioned by APIDC

APIDC

During the period under review, deficiencies were noticed in disbursement, such as non-fulfilment of terms and conditions of sanction (five cases), release on ad-hoc basis (three cases), non-verification of audited accounts during implementation (three cases) and non-installation of display board indicating project being financed by APIDC (five cases).

Monitoring system

2.4.17 Audit scrutiny revealed the following deficiencies in the monitoring system in the Corporations:

- After the final disbursement of term loan, the assisted unit was required to prepare Project completion reports (PCR) containing the information whether the assets created are as stipulated at the time of sanction. In the case of APSFC, PCRs were not prescribed to be obtained from the loanees, and in APIDC though the manual provided for it, no PCRs were being obtained from loanees. Thus in both the organisations post-disbursement monitoring was absent.

The Management (APSFC) stated (September 2006) that the Corporation at its wisdom felt that there was no need for preparation of PCRs. The reply is not tenable as in the absence of PCRs the organisation will be deprived of verifying whether assets have been created with the financial assistance given.

- Periodical inspection of assisted units is essential to safeguard the financial interests of the organisation. It was noticed that in APSFC there was no system of maintenance of either tour diaries or inspection registers to ensure that periodical inspections were conducted despite the directions issued by the Board in April 2005 in this regard.

SIDBI recommendations on appointment of nominee directors were not followed

- As per the terms of the loan agreements entered into with assisted units, APIDC is empowered to nominate directors in the assisted units. This is essential to have adequate control over the affairs of the assisted units. It was, however, noticed that nominee directors have been appointed only in respect of 128 out of 374 assisted units as on 31 March 2006.

- In APSFC, directors were not being nominated in assisted units though SIDBI had recommended (July 2004) such nomination in cases where loan amount exceeded Rs.50 lakh. The Management stated (September 2006) that nominee directors are appointed depending on the enterprise and its operations on a case to case basis.

Demand and Recovery

2.4.18 Recovery of loans advanced is one of the important functions of the APIDC and APSFC in order to plough back the funds for recycling it for the development of industrial activities in the State. The following deficiencies were noticed in this regard during audit:

APSFC

2.4.19 Operations manual prepared (March 2001) by APSFC as per the requirement for ISO certification envisaged planned results in respect of collection of principal and interest on outstanding loans. The manual indicates processes and procedures to be followed for achievement of targets. Targets set in the manual were, however, not achieved from 2001-02 to 2005-06 except in respect of collections of principal under standard category. Non-achievement of targets indicates non-compliance with procedures and processes.

Recovery performance was only 25.25 *per cent* during the five year period ending 31 March 2006

APSFC raised demands for Rs 7691.04 crore (Principal: Rs 2876.86 crore and interest: Rs 4814.18 crore) and recovered Rs 1942.04 crore (Principal: Rs. 1276.74 crore and interest: Rs 665.30 crore) (excluding pre-closure payments of Rs.197.75 crore) during the five years ending March 2006. The overall recovery was only of the order of 25.25 *per cent*. The poor performance in recovery was due to lack of prompt action under section 29 of The SFCs Act 1951 and non-initiation of action under the Negotiable Instruments Act (NI Act).

The following deficiencies were noticed in demand and recovery procedures in respect of the cases examined in audit:

Sl.No.	Nature of deficiency	Number of cases where deficiencies were noticed
1	Not invoking collateral/personal guarantee	13
2	Delay in seizure of the units	10
3	Delay in realisation of dues through court	7
4	Periodical inspection of assisted units to assess the status of the unit not carried out	4
5	Delay in issue of recall-cum-sale notices	4
6	Release of collateral securities during tenure of loan	1

The Management stated (September 2006) that recall-cum-sale notices were issued selectively as a threatening measure and further stated that there was nothing wrong in releasing collateral security during the tenure of the loan. The reply is not acceptable as the system/guidelines and the provisions of

Section 29 of the SFC Act should be scrupulously followed for transparency and to avoid any misuse of the system or extension of undue favours.

APIDC

2.4.20 APIDC raised demands for Rs 229.63 crore (Principal: Rs 50.68 crore and interest: Rs 178.95 crore) and recovered Rs 147.09 crore (Principal: Rs 58.85 crore and interest: Rs 88.24 crore) during the five years ending 31 March 2006. The percentage of recovery to demand raised was 64.06. The amount of principal recovered as furnished by the Company also included the recovery on account of One Time Settlement (OTS) and "sale of seized assets" cases. As the company did not maintain separate records/ subsidiary registers for the amounts recovered on account of settlement of loan accounts under OTS Scheme and sale of seized assets, it was not possible to check in audit the extent to which the regular demand raised on account of principal and interest was actually recovered.

Absence of system for watching recovery against post dated cheques

APSFC

There is no system of watching recoveries against post-dated cheques.

2.4.21 As per the terms and conditions of sanction of working capital term loans (WCTL) **in APSFC**, the loanee has to furnish post-dated cheques so as to ensure prompt realisation of dues. The cheques so received have a limited period of validity and must be kept under lock and key and recorded in a register with all details so that they are presented on due dates for collection without fail. Audit scrutiny revealed that there was no procedure or system of recording the cheques in a register and taking action for presenting them on due dates for collection of dues. In this connection, it was noticed in audit that:

- 226 cheques received towards WCTL with value ranging from Rs. 29,400 to Rs.1,03,000 and dated between 26 January 2003 and 15 January 2006 in Rangareddy (West) branch office were lying without being remitted into the Bank.

- In the case of sanction of WCTL to a unit (Roys Industries Ltd., Secunderabad), all the 36 post-dated cheques for Rs.1.50 crore received were not remitted into the Bank.

- In Ramachandrapuram branch office, the 30 post-dated cheques received from Alsynth Remedies Ltd. towards WCTL availed by the unit, were not remitted into the Bank on the due dates. Out of these 30 post- dated cheques, only three cheques were remitted into the bank, after delays ranging from 30 to 60 days.

The Management agreed (September 2006) to take suitable steps for accounting post-dated cheques.

Action against loanees for dishonoured cheques

APSFC

No action was taken for realization of 3013 cheques, valued Rs.39.38 crore, which were dishonoured on presentation

2.4.22 As per the provisions of the Negotiable Instruments Act 1884, whenever a cheque is dishonoured, a notice allowing fifteen days' time to repay the amount defaulted is to be issued to the loanees. Criminal action is to be initiated after expiry of fifteen days in the case of non-payment of dues. It was observed in the audit that **in APSFC** 3013 cheques worth Rs.39.38 crore were dishonoured in two branches (Vishakapatnam and Hyderbad) during the five years ending 31 March 2006. No action was initiated under the Negotiable Instruments Act for realisation of the amounts involved from the concerned parties.

The Management stated (September 2006) that action under NI Act would be initiated in selected cases. The reply is not acceptable as provisions of NI Act are meant for improving the recovery performance and need to be used for all cases of default.

Management of Non Performing Assets

APSFC

2.4.23 Non Performing Assets (NPA), as per RBI norms, during the last five years up to 2005-06 were as follows:

(Rupees in crore)

Assets Classification as at the year end	2001-02	2002-03	2003-04	2004-05	2005-06
Total assets/loan value	1113.72	1153.00	1114.66	1131.71	1197.72
Standard assets	655.28	689.06	675.64	727.31	849.58
Non performing assets (NPA)	458.44	463.94	439.02	404.40	348.14
Percentage of NPA to total assets	41.16	40.26	39.39	35.62	29.07
Loss assets	93.00	99.86	109.01	119.79	122.56
Percentage of loss assets to total assets	8.35	8.66	9.78	10.60	10.23

No separate department established as recommended by SIDBI to reduce NPAs

As per the MOU entered (November 2003) into with SIDBI and the State Government, the Corporation was to bring down the percentage of NPA to 10 *per cent* during the course of the restructuring period of five years effective from 1 April 2003. It was, however, noticed that the percentage of NPA to total loan value stood at 29.07 as at the end of 2005-06. SIDBI, though in its Performance Evaluation Report (July 2004) recommended the establishment of a separate department for proper recovery and a control system with the sole responsibility of NPA management and follow up, no action was, however, taken by the Corporation in this regard.

APIDC

2.4.24 The Company did not provide NPAs in its accounts as per RBI norms. The position of NPAs was not appraised to the Board from 2002-03 onwards. The Company's NPAs for the five years ending 2005-06 were as given below:

(Rupees in crore)

Classification of Assets as at the year end	2001-02	2002-03	2003-04	2004-05	2005-06
Total assets/loan value	153.36	123.88	118.50	115.51	230.95
Standard assets	64.01	40.61	40.11	41.79	153.77
Total NPAs	89.35	83.27	78.39	73.72	77.18
Percentage of NPAs to total assets	58.26	67.21	66.15	63.82	33.42
Loss assets	25.66	29.56	25.04	18.86	N.A.

Audit scrutiny revealed that inadequate monitoring and lack of control on recovery resulted in accumulation of NPAs.

Seizure and Disposal of Assets (APSFC and APIDC)

2.4.25 Section 29 of the State Financial Corporations Act, 1951 empowers the Corporation to acquire possession of the loanee unit and to dispose of its assets to recover dues in case of default. The above provisions of the Act were also extended to APIDC by the State Government.

The position of seizure and disposal of assets of defaulter loanees as on 31 March 2006 is tabulated below:

Sl.No.	Particulars	APSFC	APIDC
1	Seized units	429	21
2	Outstanding dues (Rupees in crore)	56.73	141.70
3	Number of units pending disposal for more than three years	285	11
4	Outstanding dues for serial No.3 (Rupees in crore)	26.09	95.31

Audit scrutiny revealed the following:

- In both the organisations, control registers/records were not maintained to indicate the units/assets seized, value of assets as per Assets Register and value of assets actually seized, to facilitate action against such promoters/loanees in case of missing assets.

- In the case of APSFC, the operations manual stipulates that the assets seized should be either sold or the case settled under OTS within six months. It was, however, observed in audit that no effective mechanism was in existence to ensure prompt action.

- In respect of cases of assets sold by APSFC during the five years ended March 2005, there were delays in seizure of assets after the decision to seize was taken. Out of 406 cases, in 22 cases assets were seized six months after the decision was taken and in 294 cases there were delays in sale of seized assets by more than one year.

- Though Section 21 of the SFCs Act envisages constitution of a Default and Disposal Advisory Committee for this purpose, no such Committee was constituted by APSFC.

The Management stated (September 2006) that there were delays in disposal of seized assets and further stated that it would continue to make all-out efforts to finalise the sale of seized assets within the prescribed time given in the ISO manual.

Investments through equity participation

APIDC

2.4.26 In order to promote and develop industries, APIDC invests in equity shares of assisted units. The Company held an aggregate investment of Rs.117.24 crore as on 31 March 2006 in 374 assisted units consisting of Rs.53.31 crore (128 units) in listed and quoted shares, Rs. 47.01 crore (240 units) in listed but not quoted shares and the balance Rs.16.92 crore in Venture Capital Fund (6 units).

Share Certificate Register was not updated

Share Certificates valued Rs. 1.97 crore were not received so far

Audit scrutiny reveled that :

- Less than one *per cent* of the amount invested was received as dividend. The dividend received ranged between 0.58 and 0.92 *per cent* only.

- The company was not obtaining the financial statements of all the assisted units to watch the declaration and receipt of dividends from the assisted units.

- The statutory auditors in their Report for the year 2002-03 had observed that there was no effective system to control, monitor and to account for the return on investments.

- The Share certificate register was not updated, verified and signed.

- Periodical verification of share certificates was not conducted and share certificates for Rs.1.97 crore invested during the five years ended 31 March 2006 in 23 units had not been received till date (September 2006).

Disinvestment

2.4.27 In order to recycle funds, APIDC resorts to disinvestment of equity by obtaining Buy Back Undertakings (BBU) from the promoters of assisted units with an understanding to buy back shares within a period of three years from the date of investment. The Company constituted (July 2005) an Internal Disinvestment Committee with seven members (including a special invitee, usually a Chartered Accountant) for negotiating with the promoters for disinvestment.

Funds amounting to Rs.51.73 crore on an average per year were not available for recycling due to delay in disinvestments

In Para 2A.7.6.3 of the Report of C&AG of India for the year ended 31 March 2001 (Commercial) - Government of Andhra Pradesh it was commented that the Company could not enforce BBU effectively and initiate legal action. Despite the above observations the Company has not taken any effective steps in this regard so far (September 2006).

As on 31 March 2006, 155 units were due for disinvestment as against 161 units from which BBUs were obtained. Only 6.15 *per cent* of the amount due for disinvestment was actually disinvested. It was observed that due to non-enforcement of BBUs effectively, funds amounting to Rs.51.73 crore on an average per year were not available for re-cycling

No effective system exists for recovery of purchase consideration on disinvestments

As per the terms and conditions of disinvestment, the promoter had to pay the initial amount of purchase consideration within 10 – 15 days from the date of receipt of offer. The balance amount was payable within three to 12 months. In case of default, purchase consideration paid initially is to be forfeited. It was noticed in audit that Rs.6.04 crore was due from 19 units as on 31 March 2006 from whom initial purchase consideration had been received. Out of this, 59 *per cent* was overdue for more than three years. The Company had not periodically reviewed and monitored disinvestment cases for forfeiting the amounts paid or initiating legal action in default cases.

Bill discounting

2.4.28 **APIDC** introduced (September 1995) a bill-discounting scheme with a view to utilise borrowed funds to get higher returns. The guidelines for sanction of bill discounting facility *inter-alia* prescribe that the:

- unit shall be profit making for at least three years and should preferably be dividend paying.
- unit shall not be a short term/medium term loanee of APIDC.
- unit shall offer collateral security in respect of direct discounting (150 *per cent*) and capital goods bill discount (50 *per cent*).

Guidelines for Bill Discounting facilities were not strictly followed resulting in non recovery of Rs.3.72 crore

During the five years ending 31 March 2006, only Rs.3.35 crore of discount income was received. On an yearly basis, discount income constituted a meagre 7.13 *per cent* to 2.10 *per cent* of turnover during this period. Out of Rs.10.73 crore due from 10 units as at the end of 2005-06, an amount of

Rs.3.72 crore was due from six units since 2002-03. Audit scrutiny of four out of 11 such cases revealed gross procedural irregularities and violations of guidelines as discussed below:

- In contravention of the guidelines, the units which availed term loans and were defaulters had been allowed bill-discounting facility.
- Adequate information on the financial position of the units had not been ascertained in some cases.
- Less amount of collateral security than that stipulated was accepted.
- One Time Settlement for bill discounting was allowed accepting amounts lesser than the amount due although the value of collateral security held was more than the dues.
- Bill discounting facility was extended to a unit which was a wilful defaulter in the past.

Some of the interesting cases noticed by audit are discussed below:

J.C. Graphics Private Ltd, Vijayawada

2.4.29 APIDC sanctioned (April 2002) and disbursed a term loan of Rs.1.37 crore to the JPGP (in instalments upto November 2002). The unit defaulted in repayment from June 2003 and the Company, instead of taking action under Section 29 of SFCs Act 1951, sanctioned (April 2005) additional loan of Rs 3.70 crore and a Bill Discounting facility for Rs.one crore. The Board of Directors in their meeting (April 2005) waived off the penal interest of Rs.3.04 lakh in respect of old loan and rescheduled the loan to fall in line with the loan sanctioned subsequently. In this case, the following irregularities were noticed:

- Sanction of term loan as well as allowing Bill discounting facility was against the prescribed guidelines.
- The Company sanctioned Bill discounting facility while the unit defaulted in repayments of the term loan.
- The Company neither obtained financial statements duly certified by the Chartered Accountants to know the financial position of the unit, nor ascertained the dues position of the unit in respect of other financial institutions as required under the guidelines.
- Collateral security valuing Rs.2.26 crore was accepted against Rs.4 crore stipulated in the special terms and conditions of sanctions.

Sujana Group of Industries

Amount due under Bill Discounting facility was settled under OTS foregoing an amount of Rs.0.36 crore and in violation of guidelines fresh Bill Discounting facility was sanctioned.

2.4.30 The Company sanctioned (1995-96) Rs. five crore towards Bill discounting facility to two industries of Sujana Group duly obtaining necessary collateral security. The promoters of the units defaulted payment and the outstanding dues were Rs.4.77 crore (as on 30 June 2003). The Board approved OTS in July 2003 for Rs.4.40 crore by extending concession of Rs.36.05 lakh even though the value of collateral security (Rs. 10 crore valued in June 2003) held was more than the total dues. The Company, instead of taking action under Section 29 of the SFCs Act, had approved OTS in July 2003 even though the two units were wilful defaulters as the units were making cash profits. The Company again in a Board meeting held on 25 June 2005 sanctioned Bill discounting facility of Rs.2.50 crore each to the two units without considering the past track record of the units.

One Time Settlement (OTS) Scheme

2.4.31 During the five years period ending 31 March 2006, APIDC settled 57 loan accounts under OTS. Audit scrutiny of ten cases revealed the following irregularities in this regard:

Sl.No	Nature of irregularity	No of cases detected
1.	Non-consideration of value of assets (primary and collateral security) held by the unit where assets were more than total dues	10
2.	Approval of OTS by the Board of Directors more than once	5
3.	Extension of time/settlement for payment of OTS amount at the intervention of the State Government	5
4.	Non-obtaining of certified financial statements	5

It was further noticed in audit that OTS was approved in several cases as follows:

OTS cases were settled indiscriminately flouting guidelines resulting in loss of Rs.14.36 crore

- in spite of the sound and profitable financial position of the loanees.
- without consideration of the solvency position of the guarantor/promoters.
- for purposes of restructuring/repayment of dues to other financial institutions.
- OTS was sanctioned for an amount which was less than the offer received and than that recommended by the State Government.
- Documents were released without receiving full OTS payment.

Thus, OTS to assisted units was extended indiscriminately flouting guidelines with the result that an amount of Rs.14.36 crore was forgone. (i.e. difference between total dues and the amount settled under OTS).

One interesting case where the Company failed to secure its own interest is discussed below:

Bhaskara Agro Chemicals Limited

As per existing guidelines of APIDC, bill discouting facitlity should not be extended if there were any outstanding dues of term loan from the assisted units. In contravention of this provision, the Company extended (March 1999) bill discounting facility of Rs.1.50 crore duly obtaining collateral securities (two open plots at Hyderabad: Rs.1.28 crore, plot at Vijayawada: Rs.0.56 crore and one residential house: Rs.35 lakh) valued Rs.2.19 crore. It was noticed in audit that the assisted unit was not prompt in payment of dues since May 2001. Inspite of this, the Company released (August 2002) one of the collateral securities (Plot at Vijayawada) on payment of Rs.60 lakh. At the same time the assisted unit approached the Company for settlement of outstanding dues under OTS. After a lapse of three years, the Board discussed (April, 2005) the OTS proposal and deferred the decision. Again, on 25 June 2005, the Board constituted a Committee for settlement of dues under OTS. The Committee approved (August 2005) OTS for Rs.1.30 crore with the dissent of three out of 11 directors, when the total dues to be recovered from the assisted unit were Rs.2.58 crore (as on 28 February 2005). The Board again, on 20 August 2005, reviewed the issue and approved OTS for Rs.1.45 crore with the dissent of three official directors and with the approval of eight non-official directors.

As there was no unanimity among the Board of Directors, the matter was referred (31 August 2005) to the State Government, which annulled (21 October.2005) the decision of the Board and advised (24 October.2005) the Company to formulate a uniform policy containing specific guidelines for settlement of dues under OTS. Meanwhile, the Company without waiting for the Government decision and without formulating uniform guidelines, sanctioned (6 October .2005) OTS for Rs.1.55 crore without the approval of the Board as against outstanding dues of Rs.2.99 crore. The Company had also released (29 October 2005) another collateral security (residential flat at Vijayawada) on payment of Rs. 45 lakh. Subsequently, the entire amount of Rs.1.55 crore towards OTS was paid by the assisted unit and the remaining collateral securities and documents were released.

Thus, due to non-formulation of specific guidelines for settlement of dues under OTS, as advised by the Government, the Company had to forgo a revenue of Rs.1.44 crore. Further, the release of collateral securities without waiting for clearance of dues was not a prudent practice, indicating a weak internal control.

The matter was reported to Government/APIDC in June 2006; their replies are awaited.

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Conclusion

The Internal Control system in both the organizations was found to be weak. Various tools of internal control such as the budget, Audit Committees and internal audit were not used effectively. The Business plan and resource forecasting could not be used as effective tools of internal control as these were neither finalized before commencement of the financial year nor were the wide variations analysed. In APIDC, no Audit committee was constituted whereas in APSFC, the Audit Committee did not discuss some of the important issues under its scope. Internal Audit was not conducted at all in APIDC, while in APSFC the Head Office transactions were not covered by the Internal Audit and compliance to their observations was not ensured. Vigilance mechanism was also found to be ineffective in APSFC. Case of inaction on suggestions made by SIDBI/Government directives were noticed. The system of recording of post dated cheques received from the loanees and their timely remittance was not in place in APSFC. Internal control in appraisal, disbursement, monitoring, demand and recovery in both the organizations was inadequate. Irregularities were noticed in bill discounting and the one time settlement scheme in APIDC.

Recommendations

- ***Both the organisations should prepare budgets in time and analyse variations with a view to using budget as an effective tool of internal control.***

- ***Audit Committee needs to be constituted in APIDC and should be gainfully utilised in both the organisations.***

- ***Internal Audit and Vigilance Departments need to be formed in APIDC and in APSFC, the internal audit and Vigilance set-up should be strengthened.***

- ***Systems and procedures prescribed for loan sanction, disbursement and recovery should be followed meticulously in both the organisations.***

- ***The organisations should dispose of seized assets within the time frame stipulated to avoid deterioration and to enable recycling of funds.***