CHAPTER-II

2. PERFORMANCE REVIEWS RELATING TO GOVERNMENT COMPANIES

2.1 OPERATIONAL PERFORMANCE OF TAMIL NADU INDUSTRIAL EXPLOSIVES LIMITED

HIGHLIGHTS

The Company was incorporated in 1983 to manufacture and supply explosives, detonators and detonating fuses for both industrial and civil use. The Company has been incurring losses since 2003-04 and the accumulated loss of Rs.30.43 crore as on 31 March 2006 has eroded its entire paid up capital.

(Paragraphs 2.1.1 and 2.1.6)

Failure to adjust the price proportionate to the quantum of deficiency in purity level and the additional expenditure incurred on removing the impurities resulted in loss of Rs.21.16 lakh to the Company.

(Paragraph 2.1.9)

Consumption of raw materials was far in excess of the norms which resulted in extra expenditure of Rs.78.81 lakh.

(Paragraph 2.1.13)

Procurement of a second cartridging machine without establishing markets for the emulsion explosives and without analysing the scope for the utilisation of the first machine resulted in wasteful expenditure of Rs.2.13 crore on procurement of second machine.

(Paragraph 2.1.15)

Engagement of contract labours despite having surplus manpower resulted in extra expenditure of Rs.2.21 crore.

(Paragraph 2.1.17)

Selling of the products below the variable cost of production and short-recovery of freight charges from the customers resulted in loss of Rs.2.68 crore to the Company during 2002-03 to 2006-07.

(Paragraph 2.1.19)

Introduction

2.1.1 The Tamil Nadu Industrial Explosives Limited (Company), was incorporated (February 1983) with the main objective of manufacturing and supply of industrial and civil explosives and other related accessories such as detonators, fuses *etc*., required by the coal mines and other industries. The Company initially set up (1986) a plant for manufacturing Nitro Glycerine (NG) explosives. This was followed by setting up of facilities for manufacture of detonators and detonating fuses (DDF) in 1989 and slurry explosives in 1991.

The possession and manufacture of NG explosives was banned (April 2004) by the Government of India (GOI). After this ban, the Company started (April 2004) manufacturing the substitute product 'Telmix' explosives for utilising the facilities hitherto available for the manufacture of NG explosives. Meanwhile, in anticipation of the ban, the Company had also commenced (May 2003) manufacture of 'Emulsion' explosives.

The Management of the Company is vested in a Board of Directors (BOD) headed by the Chairman and Managing Director (CMD). He is assisted by the General Manager (Works) and Joint General Manager (Finance) in the day-to-day affairs of the Company.

The performance of the Company was last reviewed in the Report of the Comptroller and Auditor General of India (Commercial) – Government of Tamil Nadu for the year ended 31 March 1999. The report is yet to be discussed by the Committee on Public Undertakings (September 2007). The issues such as poor capacity utilisation, surplus manpower and consumption of raw materials in excess of the norms, *etc*., pointed out in the earlier report, continued to exist during the current period of performance audit.

Scope of audit

2.1.2 The performance review covering the operational performance of the Company during 2002-03 to 2006-07 was conducted during October 2006 to March 2007 by reviewing the records maintained in the Registered Office of the Company at Chennai and the factory at Vellore.

Audit objectives

2.1.3 The performance review was conducted with a view to ascertain whether:

- the production capacities created by the Company were utilised economically, efficiently and effectively;
- production of various products was as per the targets fixed;
- the price of products fixed by the Company covered the cost of sales and measures were taken to reduce the cost;

- the available manpower was utilised effectively; and
- the system of Corporate Governance and internal control was adequate and effective.

Audit criteria

2.1.4 The audit criteria adopted for assessing the achievement of audit objectives were:

- Norms laid down by the Company in respect of capacity utilisation, consumption of raw materials, wastages and other utilities *viz.*, power *etc*;
- Policy and terms of agreement governing the purchase of raw materials and sale of products;
- Marketing policy of the Company;
- Pollution norms fixed by the State Pollution Control Board; and
- Industry norms for deployment of manpower for production.

Audit methodology

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

- budgets, costing and stores records of the Company;
- minutes and agenda notes of the meeting of BOD;
- purchase files and decisions of the competent authority;
- bids submitted for sale of explosives and other sales related records; and
- interaction with the Management and issue of audit enquiries.

Audit findings

Audit findings as a result of performance audit were reported (June 2007) to the Management/Government and discussed (7 August 2007) in the meeting of Audit Review Committee on Public Sector Enterprises. The General Manager and Joint General Manager of the Company attended the meeting. No representative from the State Government participated in the meeting. The views expressed by the Management have been taken into consideration while finalising the performance review. Audit findings are discussed in the succeeding paragraphs.

Financial position and working results

2.1.6 The financial position and working results upto 2005-06[•] are given in **Annexure-9**. It could be seen therefrom that the Company started incurring losses from 2003-04 and the accumulated losses rose from Rs.2.54 crore in 2003-04 to Rs.30.43 crore in 2005-06. The accumulated loss of Rs.30.43 crore as on 31 March 2006 had fully eroded the paid up capital of Rs.26.96 crore as on that date. The main reasons for the losses in these years were ban (April 2004) on the manufacture of NG explosives (sale of which constituted 70 *per cent* of the total sales of the Company), increase in cost of raw material, high expenditure on labour and low returns from the sale of slurry and emulsion explosives. Further analysis of the losses revealed that while realisation from the slurry explosives did not cover even the variable cost, realisations from the emulsion explosive and detonators contributed little to meet the fixed costs. Thus, none of the products manufactured by the Company was sold at profit during the last three years (except the export business and copper delay detonators).

Procurement of raw materials

2.1.7 The Company was procuring raw materials and packing materials by floating annual open tenders. While the Company awarded the contracts for its full requirement on the established sources, it awarded trial orders for nominal (upto 30 *per cent* of the requirement) quantity on the non-established sources only after getting their samples tested (in labs) at least twice. The trial orders were placed with the twin objectives of increasing the sources of supply and getting cost advantage.

Procurement of Ammonium Nitrate

2.1.8 Ammonium Nitrate (AN), which constitutes 70 *per cent* of the inputs in the manufacture of explosives, is the main raw material. This can either be acquired in melt[≠] or powdered form. The powdered form of AN is either coated or uncoated. When AN is procured in melt form, it is converted into powdered form for use in the production of explosives. While coated AN was used in the production of banned NG explosives and Telmix explosives, uncoated AN was used in the production of slurry and emulsion explosives. Audit scrutiny of the cases of procurement of AN revealed the following deficiencies:

Acceptance of defective supplies

2.1.9 The Company invited (August 2005) open tenders for the supply of 4,000 MT of uncoated AN having at least 99 *per cent* purity. Any deviation from this specification attracted rejection of the material or acceptance on adjustment of the price proportionate to the quantum of deficiency in purity.

• Accounts for the year 2006-07 are yet to be prepared by the Company. Even provisional figures were not available.

≠ AN melt is a concentrate form of ammonium nitrate, with concentration ranging between 95 to 99.9 *per cent*.

Orders were placed (September 2005) on two suppliers *viz.*, Special Blast Limited (SBL), Vishakapatnam for 2,500 MT at the landed cost of Rs.11,666 per MT and Deepak Fertilisers Petro Chemicals Limited (DFPC), Pune for 1,500 MT at Rs.11,616 per MT.

Keeping in view its requirement, the Company lifted (between September 2005 and March 2006) only 700 MT and 1,216 MT of uncoated AN from SBL and DFPC respectively against the above orders. The supplies received from them had purity ranging from 94 to 96 *per cent* as against the specified purity of 99 *per cent*. It was observed that the Company did not adjust the price proportionate to the deficiency in purity as per the terms and conditions of the contract. Failure to recover proportionate amount resulted in loss of Rs.9.55 lakh for the supplied quantity.

Failure to adjust the price proportionate to the quantum of deficiencies in purity level and the additional expenditure incurred for removing the impurities resulted in loss of Rs.21.16 lakh in procurement of ammonium nitrate.

Besides, the Company incurred additional cost of Rs.606 per MT towards excess consumption of AN, labour and steam for removal of impurities resulting in indirect loss of Rs.11.61 lakh (1,916 MT X Rs.606). Thus, the Company suffered a total loss of Rs.21.16 lakh in the purchase of 1,916 MT of uncoated AN. Further, the Company did not collect security deposit from the two suppliers in contravention of its normal practice of collecting Rs.25,000 towards security deposit.

The Management stated (August 2007) that since it was at the mercy of the suppliers, it could not invoke penal provisions of the purchase orders. The reply is not tenable as the Company could have recovered proportionate amount as envisaged in the tender conditions from the suppliers.

Non-awarding of full quantity to the lowest tenderer

Failure to award a contract for a minimum quantity to the lowest firm on trial basis resulted in avoidable expenditure of Rs.4.97 lakh.

2.1.10 In the tender finalised (March 2003) for conversion of AN melt into AN powdered form, Dalmia Chemicals (DC), a new tenderer, quoted the lowest rate of Rs.3,500 per MT as against the negotiated rate of Rs.3,825 per MT quoted by the established supplier (second lowest). The Company however, citing the non-established nature of DC, the lowest firm, placed (April 2003) orders on the second lowest tenderer at the higher rate. The quality of materials supplied by DC was tested as early as in the year 2000 and found to be suitable. Failure to award the contract for at least 30 *per cent* of the requirement on trial basis on the lowest firm resulted in avoidable expenditure of Rs.4.97 lakh.

The Management stated (April 2007) that DC was not selected as they did not furnish bid bond while submitting the tender. The Management further stated (August 2007) that DC had also not submitted bank guarantee. The reply is an after thought since the offer of DC was rejected citing it a non-established supplier and not due to its non-submission of bid bond. Further, the question of bank guarantee arises only after awarding contract and no order was placed on DC during 2003-04. Moreover, DC had requested the Company to use their bid bond submitted against earlier tender in March 2002, which was not returned to DC till the date of opening of tender floated in March 2003.

Production performance

2.1.11 The Company prepared production budget **(Annexure-10)** based on the estimated sales. Annexure-10 shows that the actual production as a percentage of the budgeted production had declined in all divisions in 2005-06 and 2006-07.

Capacity utilisation

2.1.12 The performance of the four divisions (Emulsion, NG/Telmix, Slurry and DDF explosives) in terms of capacity utilisation is given in the following table.

Sl No	Division	Capacity	Capacity utilisation (In *per cent*)				
			2002-03	2003-04	2004-05	2005-06	2006-07
1.	Emulsion[♣] (10,500 MT/ 16,500 MT from 2005-06)	Bulk – 1,500 MT	NIL	8	NIL	6	6
		Small dia – 5,000 MT / 10,000 MT from January 2006	NIL	4	57	45	20
		Large dia – 4,000 MT	NIL	3	16	13	32
2.	NG / Telmix	9,000 MT	90	76	11	7	3
3.	Slurry	6,000 MT	58	71	85	67	35
4.	DDF						
(a)	Detonators	450 lakh numbers	72	61	101	90	77
(b)	Detonating fuses	110 lakh meters / 120 lakh meters from 2004-05	98	133	119	115	113

Source: Data furnished by the Company.

It could be seen from the table that:

- Capacity utilisation of Emulsion (Bulk) ranged between 6 to 8 *per cent* during 2003-04 and 2005-07. During 2002-03 and 2004-05 there was no production. Capacity utilisation of small dia ranged between 4 to 57 *per cent* during 2002-07 with no production in 2002-03. Capacity utilisation of large dia ranged between 3 to 32 *per cent* during 2003-07. There was no production in 2002-03.
- Capacity utilisation of NG/Telmix reduced from 90 *per cent* in 2002-03 to 3 *per cent* in 2006-07.

♣ The emulsion division was operationalised in 2003-04.

- Capacity utilisation of slurry ranged between 35 to 85 *per cent* during 2002-07.
- Capacity utilisation of detonators ranged between 61 *per cent* to 101 *per cent* during 2002-07.

Consumption of raw materials

2.1.13 The Company determines the formulations of various explosive products by utilising the services of its Research and Development (R&D) wing/consultants. After conducting lab trials, plant trials and field trials, the formulations are approved by the Chief Controller of Explosives (CCE). The norms for consumption of raw material are fixed as specified in the formulations approved by CCE.

Norms fixed for consumption of Ammonium nitrate and Oronite Lubricant Oil Additives (OLOA) in the production of various explosive products and actual consumption of raw material for the five years ending 2006-07 are given below:

Sl No	Name of the Product	Quantity produced (MT)	Consump-tion as per norms (in kg per MT)	Actual consump tion (in kg per MT)	Excess quantity consumed (in kg per MT)	Percentage of excess over the norms	Value of excess consump tion (Rupees in lakh)♣
	Consumption of Ammonium Nitrate						
1	Telgel	3,566	620	655	35	5.65	13.61
2	Telprime	2,922	620	642	22	3.55	6.82
3	Telgel Supreme	9,871	502	527	25	4.98	27.80
4	Telboost	2,554	478	502	24	5.02	7.17
5	SD emulsion (in 2003-04 only)	327	856	1,232	376	43.93	14.52
	Consumption of OLOA						
6	Small dia Emulsion	7,287	9	10.24	1.24	13.78	8.89
	TOTAL						**78.81**

Source: Data furnished by the Company.

Consumption of raw material in excess of the norms resulted in avoidable excess expenditure of Rs.78.81 lakh.

It could be seen from the above details that the consumption of raw material was in excess of the norms by 3.55 to 43.93 *per cent* resulting in avoidable excess expenditure of Rs.78.81 lakh.

The Management stated (August 2007) that the abnormal consumption of AN in the manufacture of SD emulsion explosives was due to trial production for introducing the product in the market. It was further stated that the variance analysis of consumption as per norms *vis-a-vis* actual consumption was not

♣ Computed with reference to the rates fixed by the Company every year.

carried out. The reply indicates that the Company did not utilise the norms as a tool to control the variable cost of production.

Utilisation of Machinery

2.1.14 The Company did not maintain any records to indicate the machine-hours available and machine-hours utilised to determine capacity utilisation and to identify reasons for idleness if any, despite being commented in the previous review (*vide* Paragraph 2B.11) of Audit Report (Commercial) – 1998-99 - Government of Tamil Nadu. In the absence of details, the audit was not able to comment on the utilisation of the machinery.

Cartridging machine[*]

Procurement of a second cartridging machine without establishing market for the emulsion explosives and without analysing the scope for the utilisation of the first machine resulted in wasteful expenditure of Rs.2.13 crore on procurement of second cartridging machine.

2.1.15 In anticipation of the ban on NG explosives, the Company decided (January 2001) to manufacture three kinds of emulsion explosives *viz.*, small dia, large dia and bulk explosives. The Company prepared (March 2002) a financial appraisal of emulsion project which projected the sales of small dia explosives to increase by 1,000 MT *per annum* from 1,000 MT in the first year upto the fourth year. After the fourth year, the sales were projected to be stagnant at 6,000 MT till the eleventh year. The report further stated that the capacity should be increased after establishing the product in the market.

The Company imported (April 2003) a cartridging machine with a capacity of 5,000 MT *per annum* for packing the small dia explosives and installed it at a total cost of Rs.3.24 crore. The commercial production of emulsion explosives was started in September 2003. The production of the small dia explosives since commissioning of the machine was 213 MT (4.26 *per cent*) in 2003-04 and 2,870 MT (57.4 *per cent*) in 2004-05 as against the installed packing capacity of 5,000 MT *per annum*.

Despite the under utilisation of the cartridging machine, the Company imported (December 2004) one more cartridging machine with a capacity of 5,000 MT *per annum* at a cost of Rs.2.13 crore (Rs.1.15 crore for machinery and Rs.0.98 crore for installation). It was, however, noticed that the actual production was just 2,047 MT (20.47 *per cent*) in 2005-06 and 1,984 MT (19.84 *per cent*) in 2006-07 of the total installed capacity of 10,000 MT *per annum*.

The Management stated (August 2007) that it had gone for purchase of the second cartridging machine to meet the expected demand. It was, however, observed that when the purchase order was placed (August 2004) for procuring the second cartridging machinery, production of small dia explosives and cartridged quantity by the first machine was only 1,333 MT during April to August 2004 against the capacity of 5,000 MT *per annum*.

Thus, the procurement of the second machine without establishing the market for the said product and analysing the scope for the maximum utilisation of the

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* It is a packing machine used to pack small dia emulsion explosives.

capacity of the first machine itself resulted in wasteful expenditure of Rs.2.13 crore.

Bulk Emulsion plant and Bulk Delivery System

Failure to obtain firm commitments prior to establishments of facilities at a cost of Rs.0.76 crore for manufacture and delivery of bulk emulsion explosives exclusively to NLC, rendered the facilities infructuous.

2.1.16 The Company established (June 2003) a bulk emulsion plant having a capacity to manufacture 1,500 MT *per annum* at a cost of Rs.44.88 lakh and also acquired (January 2003) a bulk delivery system at a cost of Rs.30.85 lakh to cater to the requirements of Neyveli Lignite Corporation Limited (NLC) – a Central Government Public Sector Undertaking. The Company, however, did not enter into any formal contractual arrangement with NLC for continued procurement of the bulk emulsion explosives. The Company executed only trial orders of 114.13 MT and 81.30 MT of bulk emulsion explosives for NLC in 2003-04 and 2005-06 respectively and the said production facilities remained unutililsed in 2004-05. The Company could obtain regular order for bulk supply of 1,500 MT of the explosives only in 2006-07. The Company, however, supplied only 89 MT during 2006-07 and did not supply the balance quantity as:

- the price accepted did not even cover the variable cost; and
- the claim of the Company for increase in the accepted price based on 39 *per cent* increase in the price of the main raw material *viz.*, Ammonium Nitrate was not acceded to by the NLC.

Thus, failure to obtain firm commitments from NLC prior to establishment of the facilities exclusively for NLC coupled with the Company's inability to reduce variable costs resulted in idling of the bulk emulsion plant and delivery system created at a cost of Rs.75.73 lakh.

Utilisation of manpower

2.1.17 The Company, considering the imminent ban on NG explosives, started redeployment (2003-04) of its employees working in the NG division to other divisions. The Company diverted (2003-04) 47 out of 172 employees employed in the NG division to the newly created Emulsion division. After the ban (April 2004) on NG explosives, the Company retained 65 employees in the NG division for the manufacture of the new product 'Telmix' explosive and transferred the remaining 60 employees to other divisions. Audit, however, noticed that production, which was 45 MT per employee in the NG division earlier, had come down to about 15 MT per employee (during 2004-05 and 2005-06 and to five MT in 2006-07) in manufacturing Telmix, indicating gross underutilisation of the available manpower**.**

Engagement of contract labours despite having surplus manpower resulted in extra expenditure of Rs.2.21 crore.

Aware of the surplus manpower, the Company decided (July 2002) to implement Voluntary Retirement Scheme (VRS) to reduce the manpower. While noting the status of implementation of VRS, the BOD decided (October 2002) to constitute a committee to identify the surplus manpower. The Committee, has not yet (August 2007) taken up that study. It was noticed that in spite of having surplus manpower, the Company engaged contract labourers for various works incurring expenditure of Rs.2.21 crore on their pay and allowances during the last five years ending 31 March 2007.

The Management stated (April 2007) that though it was aware of the existence of surplus manpower, outsourcing of certain works was resorted to as productivity of its own labour was not as high as that of the contract labour. It further stated (August 2007) that it had appointed Anna Institute of Management Studies for assessing the requirement of manpower and based on their recommendations further steps would be taken. The reply is not tenable as the Company has yet to appoint an agency for assessing the requirement of manpower. The fact, however, remains that by outsourcing the work, on one hand manpower of the Company remained under-utilised and on the other hand it had to pay Rs.2.21 crore to the contract labours. Further, the Company failed to identify the surplus manpower and take necessary steps to overcome it even after five years of its decision to implement VRS.

Sales performance

2.1.18 The Company sells slurry explosives to the organised sector, emulsion and telmix explosives to the trade sector and DDF to both the sectors. Besides, the Company exports explosives and DDF. The Company has, however, not formulated any marketing policy to compete in the market.

The sector-wise sales performance for the last five years ended 31 March 2007 is given below:

(Rupees in crore)

Year	Domestic sales			Export	Total
	Organised	Trade	Total		
2002-03	11.70	31.05	42.75	1.57	44.32
2003-04	12.34	27.78	40.12	2.49	42.61
2004-05	13.86	15.12	28.98	1.07	30.05
2005-06	10.86	14.27	25.13	2.28	27.41
2006-07	6.51	12.83	19.34	3.92	23.26

Source: Data furnished by the Company.

Sale to the organised sector

Selling of products below variable cost led to cash loss of Rs.1.52 crore. Acceptance of fixed freight charges irrespective of the distance resulted in further cash loss of Rs.1.16 crore on transportation of the products sold.

2.1.19 The Company participated in the open tenders floated by companies in the organised sector like Coal India Limited (CIL), Singarani Collieries Limited (SCL), Neyveli Lignite Corporation Limited (NLC), *etc*. The rates quoted by the Company had no reference to its budgeted/production cost and in some cases, the quoted rates were only meeting the variable cost. On many occasions, the rates quoted were even below the variable cost resulting in cash losses amounting to Rs.1.52 crore♦ during the last five years ending March 2007. Out of 14 products which caused the said cash loss, the below

♦ Estimated variable cost is taken for 2006-07.

mentioned three products alone were responsible for cash loss of Rs.1.34 crore.

Sl No	Name of the product	Quantity sold (in MT)	Amount realised	Variable cost excluding labour cost	Labour cost *	Cash loss excluding labour cost
			(Rupees in lakh)			
1	Telgel Supreme	6,133.50	654.12	728.77	90.05	74.65
2	Powertel Blast	2,124.70	302.15	339.46	21.92	37.31
3	Telboost 125mm	1,499.85	209.75	231.98	17.70	22.23
TOTAL					**129.67**	**134.19**

Source: Data furnished by the Company.

Besides, for 'door-delivery' of the products, the PSUs were paying the Company a fixed sum per MT as freight charges irrespective of the distance covered. However, the actual freight charges paid by the Company were more resulting in further cash loss of Rs.1.16 crore during 2002-03 to 2005-06♣ as detailed in the table below.

Sl No	Name of the product	Quantity sold (in MT)	Amount spent on freight (Rupees/MT)	Freight amount recovered (Rupees/MT)	Freight charges borne by the Company (Rupees in lakh)
1	Telgel	2,500.95	2,688 to 3,821	835 to 950	30.08
2	Telprime	733.67	2,688 to 3,821	835 to 950	12.53
3	Telgel supreme	5,598.80	1,547 to 2,191	426 to 800	57.52
4	Telboost	1,404.40	1,547 to 2,191	426 to 800	15.81
TOTAL					**115.94**

Source: Data furnished by the Company.

The Management stated (April 2007) that it was forced to sell below the variable cost due to stiff competition and rising price of raw materials and as the freight element was dictated by the buyer, it had played down the cost of freight while participating in the tenders.

It is pertinent to note that the Audit Committee of the Company was of the view (July 2004) that there was no compulsion to produce and sell products, which yielded negative contribution. The Committee recommended that BOD take up the review of manufacturing and selling of products, which yielded

* Does not include labour cost for 2006-07.

♣ There was no such freight loss during 2006-07 as the Company did not get orders from major customers during that year.

cash losses continuously for the past several years. The Company, however, did not initiate any action to stop producing such products. Thus, production of the products in disregard to their profitability was another reason for its continued losses.

Short supply

Failure to supply the indented quantity despite having adequate production capacity resulted in contribution loss of Rs.1.13 crore.

2.1.20 After the ban of NG explosives, one of the products, which brought sizeable profit to the Company was Copper Delay Detonators (CDD 2.5 metres). This was supplied to the coal mining companies in the organised sector.

Audit scrutiny revealed that the Company received indents from CIL and SCL for supply of 177.53 lakh detonators during 2002-03 to 2005-06 (no orders were received during 2006-07). The Company supplied 158.77 lakh detonators and could not supply the balance quantity of 18.76 lakh detonators despite having adequate production capacity. This resulted in contribution loss (sale price *minus* variable cost) of Rs.1.13 crore during this period.

The Management stated (August 2007) that Form-37, a statutory indenting form to be given by the user of explosives was for the quantity less than the ordered quantity. The reply is not tenable as the Company failed to supply even the indented quantity, as stated above, resulting in loss of contribution.

Export sales

2.1.21 As per export sales performance (**Annexure-11**), the Company's export sales ranged between 2.36 *per cent* to 5.60 *per cent* of the total exports by the industry and ranged between 3.53 *per cent* to 23.51 *per cent* of the total sales of the Company during the period 2002-03 to 2006-07. The Management stated (August 2007) that it had formed (August 2007) joint venture (Maxam Tel Explosives Private Limited) with Maxam India Private Limited (Maxam), a subsidiary of Maxam Australia for marketing its products in India and abroad with the technical know-how provided by Maxam Australia. According to the Company, the joint venture is expected to give fillip to its export business. Further developments are awaited (September 2007).

Research and Development

2.1.22 The objectives of Research and Development (R&D) are to conduct research on developing new indigenous products and improve upon the existing composition of raw materials in various products to reduce the cost of production.

The expenditure of Rs.0.92 crore incurred on Research and Development activities did not serve the intended purpose.

The service rules of the Company provide that a Manager should head the R&D wing. The service rules did not prescribe any qualification for the post. The post of Manager has been lying vacant since April 1994 and at present, the unit is headed by an Assistant Manager with one officer, three assistants and five workmen reporting to him. The Company had incurred Rs.63.72 lakh and Rs.27.82 lakh towards recurring and capital expenditure respectively on R&D activities during the last five years ending March 2007.

It was observed that the R&D unit of the Company had neither developed indigenous product nor improved upon the existing explosives so as to reduce the cost and consequently the cash losses of the Company. Further, the Company developed new products with the assistance of outside research institutes and experts during the last five years by incurring consultancy charges of Rs.43.70 lakh. Thus, the expenditure incurred on R&D activities amounting to Rs.91.54 lakh did not serve the intended purpose.

The Management stated (April 2007) that the Research and Development wing would be reoriented after the establishment of a joint venture with Maxam for a new project.

Corporate Governance

2.1.23 Corporate Governance is the system by which companies are directed and controlled by the Management in the best interest of the shareholders and others ensuring greater transparency and better and timely financial reporting. The BODs are responsible for the governance of their companies.

Meetings of the Board of Directors

2.1.24 The BOD of the Company comprised of eight directors representing the State Government (including one whole time Director - the MD and ex-officio Chairman) and four independent directors as on 31 March 2007.

In the Company, all the Directors of the Board were never present in any of the 22 meetings held during the last five years ended 31 March 2007. Of the two Government nominee Directors, one director did not attend seven and the other director did not attend nine meetings out of 11 and 12 meetings held respectively during 2004-05 to 2006-07. Four independent Directors failed to attend three to six meetings during the same period. One Government nominee Director and one independent Director did not attend any meeting in 2003-04.

Though the Board was aware that the loss being incurred by the Company was due to high raw material and labour costs and selling almost all the products below the cost of production, it exhibited no seriousness in addressing these perennial issues. It appears that poor management was one of the causes of the poor performance of the Company.

Internal Control

2.1.25 In order to achieve its objectives, every organisation requires to have an effective system of internal control to ensure that all the activities of the Company are performed in accordance with the rules, standards, procedures and system for accomplishment of desired goals. The following deficiencies were noticed in the system of internal control followed by the Company.

Costing

2.1.26 The job of the costing department is to correctly allocate the cost of production on various products and communicate the same to the marketing department so as to quote appropriate selling price for the products. Audit scrutiny of costing records revealed that:

- While arriving at the cost of production, the salaries, wages and allowances paid to all the employees including directly engaged in the manufacturing activities have been treated as fixed cost along with other fixed cost elements such as depreciation. The variable cost of the product as established by the Company represented only the cost of direct material, packing material, power and fuel and did not include the direct labour cost.
- The actual cost of its product was more than the budgeted cost and the actual cost of various products ranged from 3.34 *per cent* to 180.59 *per cent* over the budgeted cost in 2004-05 and 2005-06 and no analysis was made by the Company so as to take necessary measures to control the cost. The budget for the year 2006-07 was not submitted to the Board for approval.
- The cost of all the five small dia emulsion explosives was found to be same in every year for all the three years from 2003 to 2006, though requirement of raw material was different for each of the five varieties. This is an example of defective costing adopted by the Company.

Internal Audit

2.1.27 The internal audit department is manned by two exclusive staff under the supervision of one officer. The following deficiencies were noticed in the internal audit system being followed by the Company.

- Though the department had to report directly to the CMD, its findings were always routed through head of accounts department indicating existence of conflict of interests in discharging internal audit functions.
- As many as 39 internal audit observations out of 63 observations issued during 2004-05 to 2006-07 are yet to be replied by the concerned departments indicating that internal audit as a control mechanism is not being utilised effectively by the Company.
- Statutory auditors of the Company have also commented on lack of follow-up by the Company on internal audit suggestions in 2004-05.

Conclusion

The Company failed to economise the procurement of raw material and to achieve the norms fixed for the consumption of the same. The Company failed to assess the actual manpower required leading to under utilisation of the available manpower. The decision to procure second cartridging machine without fully utilising the capacity of the first machine and establish Bulk Emulsion plant and Delivery System without any firm commitment for purchase of the product from NLC resulted in

idling of these machines. The Company failed to realise the cost of production for almost all of its products sold and could not realise even the variable cost excluding the direct labour cost in selling some of the products. The share of the Company in the exports (profit making activity) of explosive was meagre with reference to the total exports by the industry. The poor participation of Directors in the meetings of BOD indicated lack of seriousness to address the problems faced by the Company.

Recommendations

- **The Company should prioritise cost cutting in all its divisions if it has to compete with the private sector in the market.**
- **Strategic planning should be complemented by strategic decision making. The Company should consider discontinuation of production of those products not found economically viable and concentrate on the areas such as exports, where it can earn more profits.**
- **The Company has an enormous unutilised manufacturing capacity, which needs to be properly utilised by aggressive and cost effective marketing.**
- **The BOD and the Government should closely monitor the working of the Company so as to bail it from loss within a time frame.**

The matter was referred to the Government in June 2007; and their reply is awaited (September 2007).

2.2 PERFORMANCE REVIEW OF THE HOTEL AND TRANSPORT DIVISIONS OF TAMIL NADU TOURISM DEVELOPMENT CORPORATION LIMITED

HIGHLIGHTS

The Company set up (June 1971) with the main objective of promotion of tourism in the State could not achieve its objectives as the tourists availing its facilities were negligible.

(Paragraphs 2.2.1 and 2.2.7)

The percentage of capacity utilisation in the hotels with reference to the availability of beds was stagnant during the review period except in 2006-07 when there was marginal increase (5.81 *per cent*) as against an increase of 25.03 *per cent* in the tourist inflow in the State. The Company lost 18.10 lakh tourists to the private sector during 2002-07.

(Paragraph 2.2.7)

Non-achievement of the break even occupancy in hotels resulted in cash loss of Rs.1.39 crore during 2002-2007.

(Paragraph 2.2.10)

Absence of favourable mix in food stuff, increased fixed cost coupled with excess food and fuel costs over norms resulted in cash loss of Rs.1.46 crore in 11 to 17 catering units.

(Paragraph 2.2.13)

The Company's efforts to franchise its uneconomical lodging and catering units were largely unsuccessful.

(Paragraph 2.2.15)

Introduction

2.2.1 Tamil Nadu Tourism Development Corporation Limited (TTDC) was incorporated (June 1971) with the main objective of promotion of tourism in the State by building up of adequate tourism related infrastructural facilities on commercially viable basis.

The Company at present is engaged in the following activities:

- Operating hotel units with lodging, restaurant and bar facilities,
- Conducting package tours,
- Conducting tourist and industrial fair in Chennai for three months from January to March every year,
- Operating 10 boating houses and maintaining Lake Park in Ooty and Thiruvalluvar Statue in Kanyakumari and
- Operating a petrol bunk at Mamallapuram as an agency.

For operational purpose, the Company has four divisions namely (i) Hotel division, which undertakes the activities of lodging, catering, boating and running a petrol bunk, (ii) Transport division, which conducts package tours, (iii) Trade fair division and (iv) Thiruvalluvar statue operation at Kanyakumari.

As on 31 March 2007, the Company had 56 hotels including the drive-in restaurant at Chennai. Out of these, 14 hotels are on franchise, two hotels on long term lease and two hotels in Courtallam merged as one for operational purpose. The Company was operating 26 hotels with lodging, catering and bar facilities and of which the restaurants in four hotels were franchised and restaurants in two hotels were not operated. 12 hotels were not being operated pending finalisation of the franchise. The drive-in restaurant at Chennai earmarked for franchise was under operation of the Company.

The management of the Company is vested with a Board of Directors (BOD) including the Managing Director (MD), who is assisted by the Chief Accounts Manager-cum-Secretary and Assistant Chief Manager (Hotels Division) in the day-to-day management of the Company. During the period 2002-07, eight MDs were appointed and only one MD worked for more than two years.

The performance of the Company was last reviewed in the Report of the Comptroller and Auditor General of India (Commercial) Government of Tamil Nadu, for the year ended 31 March 1998. The review is yet to be discussed by the Committee on Public Undertakings (September 2007). The issues such as poor room occupancy, poor maintenance and services pointed out in the earlier Audit Report continue to exist during the current period of review also.

Scope of audit

2.2.2 A performance review of the operational performance of the Hotel and Transport Divisions of the Company during 2002-03 to 2006-07 was conducted between September 2006 and May 2007. The records maintained at the Registered Office of the Company at Chennai and in 16 out of 26 hotel units and in the Transport Division were test checked.

Audit objectives

2.2.3 The Performance review was conducted with a view to ascertain whether:

- tourism policy of the State Government/Government of India (GOI) have been implemented effectively;
- there was well defined market strategy to tap prospective tourists;
- adequate infrastructural facilities, amenities and manpower was available in the Hotel and Transport divisions;
- the Hotel and Transport divisions were managed economically efficiently and effectively; and
- the franchising of the hotels was done in transparent manner.

Audit criteria

2.2.4 The Audit criteria considered for achieving the audit objectives were:

- Tourism policy of the State Government and the GOI;
- Guidelines prescribed for franchising of the hotel units by the State Government and decisions of the BODs;
- Norms for occupancy of the hotels, food cost, input output ratio for food items and consumption of fuel as fixed by the Company; and
- Revenue and physical targets fixed for the hotel and transport divisions.

Audit methodology

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

- Tourism policy of the State Government and GOI;
- Minutes and agenda notes of the meetings of BOD, budgets, targets and reports submitted by the units;
- Records maintained in the selected units; and
- Interaction with the Management and issue of audit enquiries.

Audit findings

Audit findings as a result of test check were reported (June 2007) to the Management/Government and were also discussed (August 2007) in the meeting of the Audit Review Committee on Public Sector Enterprises. The Secretary, Tourism and Culture Department and the MD of the Company attended the meeting. The views expressed by the members during the meeting were taken into account while finalising the performance review. Audit findings are discussed below:

Financial performance

2.2.6 The Expert Committee constituted (January 1997) by the State Government for reviewing the performance of Public Sector Undertakings (PSUs) recommended (September 1997) that the running of hotels and or organising tours be left to private entrepreneurs. The BOD while considering the Report of the Committee resolved (November 1997) to economise the expenditure and run the Company profitably. The Company wiped off its accumulated losses in 2003-04 and since then it has been earning profit. The financial performance and working results of the Company for the last five years ending 2006-07 are given in **Annexure-12**.

Growth of tourism

2.2.7 The number of tourists who visited the State *vis-a-vis* those availed lodging facilities in the Company's hotels during 2002-07 is given in the following table.

(In lakh numbers)

	Particulars	2002-03	2003-04	2004-05	2005-06	2006-07
1.	Number of tourists[♣] visited Tamil Nadu					
	(a) Domestic	249.43	275.58	301.93	341.40	428.08
	(b) Foreign	8.86	9.42	10.67	12.19	14.03
	TOTAL	**258.29**	**285.00**	**312.60**	**353.59**	**442.11**
2.	Percentage of tourist growth	4.44	10.34	9.68	13.11	25.03
3.	Operated Capacity of the Company's hotels (In lakh beds)	6.49	6.57	6.51	6.45	6.46
4.	Tourists availing accommodation in the Company's hotels					
	(a) Domestic	2.79	2.89	2.73	2.69	3.07

♣ Source: Reports published by the Commissioner of Tourism, Government of Tamil Nadu.

	Particulars	2002-03	2003-04	2004-05	2005-06	2006-07
	(b) Foreign	0.04	0.05	0.04	0.04	0.04
	TOTAL	**2.83**	**2.94**	**2.77**	**2.73**	**3.11**
5.	Percentage of tourists (both domestic and foreign) availing Company's facilities	1.10	1.03	0.89	0.77	0.70
6.	Percentage of growth of tourists staying in the Company's hotels	(-)3.80	3.89	(-)5.78	(-)1.44	13.92
7.	Percentage of tourists stayed to the operated capacity of the Company's hotels	43.61	44.75	42.55	42.33	48.14
8.	Number of tourists lost to the private sector (3 – 4)	3.66	3.63	3.74	3.72	3.35

The percentage of capacity utilisation in the hotels with reference to the availability of beds was stagnant during the review period except in 2006-07 when there was marginal increase (5.81 *per cent*) as against an increase of 25.03 *per cent* in the tourist inflow in the State. The Company lost 18.10 lakh tourists to the private sector during 2002-07.

It will be seen from the table that as against increase of 71.17 *per cent* during 2002-07 in the tourists' inflow in the State, there was marginal increase of 9.89 *per cent* in the number of tourists availing facilities of the Company. While the percentage of annual growth of tourist inflow in the State increased from 4.44 *per cent* in 2002-03 to 25.03 *per cent* in 2006-07, the percentage of annual growth of tourist who stayed in the Company's hotels was negative during 2002-03, 2004-05 and 2005-06. The percentage of tourists (both domestic and foreign) availing Company's facilities declined from 1.10 *per cent* in 2002-03 to 0.70 *per cent* in 2006-07. The percentage of capacity utilisation in the hotels with reference to the availability of beds was stagnant during the review period except in 2006-07 when there was marginal increase (5.81 *per cent*) as against an increase of 25.03 *per cent* in the tourist inflow in the State. The Company lost 18.10 lakh tourists to the private sector during 2002-07.

The Company did not analyse the reasons for low patronage/share of the tourists for its hotels despite increase in tourists' inflow in the State. Further, the Company did not evolve any long-term Corporate Plan for attracting the tourists to stay in its hotels.

The Management stated (April 2007) that the tsunami in December 2004 and heavy rainfall during November and December 2005, besides lack of up-gradation of facilities, poor standard of customer service due to shortage of manpower and stiff competition from private hotels were the major reasons for the negative growth in tourist stay in its hotels. The reply is not tenable as even in December 2004 and November 2005 and December 2005 there was no drop in the inflow of tourists in the State♦. As regards other constraints, they being controllable, the Company could have overcome these constraints.

♦ Source: Reports published by the Commissioner of Tourism, Government of Tamil Nadu.

Performance of Hotel division

The income from hotel division decreased from 57.76 in 2002-03 to 49.61 *per cent* in 2006-07.

2.2.8 The financial performance of the hotel division (including petrol bunk operation) for the five years ended 31 March 2007 is summarised in the **Annexure–13**. It was noticed that the percentage of income of the hotel division (excluding petrol bunk) to the total income of the Company showed decreasing trend from 57.76 *per cent* in 2002-03 to 49.61 *per cent* in 2006-07. Out of the four sectors of the hotel division *viz*., lodging, catering, boating and bar; while the boating and bar sectors showed profit, the lodging sector incurred loss in 2005-06 and the catering sector was incurring losses in all the years.

The Management stated (April 2007) that the reduction in income of the hotel division as compared to the total income of the Company was due to franchising of the hotel units and also due to increase in share of other income. The reply is not tenable since the reduction in income of hotel division was also due to stagnant room occupancy in the hotels, unfavourable mix in food stuff, *etc*., as discussed in subsequent paragraphs.

Performance of the lodging sector

Low budgetary target

2.2.9 The monthly financial performance of each hotel indicating the budgeted income and expenditure and actuals are prepared at the Regional Managers' level and then consolidated and placed before the BOD for appraisal. The details of budgeted and actual income for the operating hotels for the period 2002-07 are given below:

(Rupees in lakh)

Particulars	2002-03	2003-04	2004-05	2005-06	2006-07
Budgeted income	723	711	709	708	747
Actual Income	621	634	638	650	798
Shortfall in income	102	77	71	58	Nil
Percentage of achievement over budget	85.89	89.17	89.99	91.81	106.82
Percentage of increase/decrease (-) in budgeted income over the previous budget	(-)3.42	(-)1.66	(-)0.28	(-)0.14	5.51
Percentage of increase in budget over the previous year income	15.68	14.49	11.83	10.97	14.92

Source: Data furnished by the Company.

There was shortfall in actual income from lodging sector by Rs.3.08 crore as against the soft target fixed.

It could be seen from the table that even though the budgeted income showed a decreasing trend over the years except in 2006-07, the Company could achieve the budgeted income only in 2006-07. The actual income during 2002-06 showed only marginal increase. There was shortfall in actual income by Rs.3.08 crore as against the soft targets fixed during the period 2002-06.

The Management stated (April 2007) that in the context of non-achievement of even the low level of budget fixed for the lodging sector, higher fixation of target would have been merely an arithmetical exercise. The reply does not reflect the desired Management attitude. Budgeting was resorted to merely for formality than as a tool for control and progress. Even though the target fixed was showing decreasing trend, the actuals were not matching the targets. No variance analysis of the unit-wise performance was made to ascertain the reasons for taking corrective actions. Fact is that during 2002-07 the tourist growth increased from 4.4 *per cent* to 25.03 *per cent* and an aggressive marketing strategy and dedicated implementation would have definitely increased the actual income over budgeted income during 2002-06.

Low occupancy level

2.2.10 The table below indicates the number of hotels, average occupancy, number of hotels achieving the breakeven occupancy level and number of hotels not achieving the breakeven occupancy level and the cash loss due to non-achievement of the breakeven occupancy level.

Sl. No.	Particulars	2002-03	2003-04	2004-05	2005-06	2006-07
1.	Total number of units	25	26	26	26	26
2.	Average occupancy ratio (in *per cent*)	49	49	49	49	54
3.	Number of units above the break even occupancy	11	15	18	14	17
4.	Number of units below the break even occupancy	14	11	8	12	9
5.	Cash loss♣ due to non achievement of the break even occupancy (Rupees in lakh)	28.27	19.14	16.93	42.95	31.58

Non-achievement of break-even occupancy by 14 out of 26 hotels resulted in suffering cash loss of Rs.1.39 crore.

From the above, it could be seen that the average level of room occupancy remained static around 49 *per cent* during 2002-06 and increased to 54 *per cent* only in 2006-07, despite the fact that during 2002-07 the tourist growth increased from 4.4 *per cent* to 25.03 *per cent*. Out of 26 hotels, the number of hotels not achieving the break even occupancy ranged between eight and

♣ Cash loss means loss incurred before charging depreciation.

14 and the non-achievement of the breakeven occupancy deprived the Company from accommodating 1.06 lakh tourists during 2002-07 resulting in cash loss of Rs.1.39 crore. The hotels located at Pitchavaram, Sathur, Salem, Tirunelveli and Ulundurpet were consistently making losses (total loss of Rs.60.52 lakh) during 2002-07. In spite of identifying (October 2000 and June 2002) the hotels at Sathur, Salem and Tirunelveli for franchising due to their unviability, the Company continued with the operations of these hotels instead of franchising or closing them resulting in continued cash losses.

The main reason for low occupancy was poor maintenance, poor room service and ineffective publicity as discussed in succeeding paragraphs.

Further, the policy note on tourism of the State Government for 2003-04 aimed at achieving occupancy of 60 *per cent*. The Company, however, did not fix any annual target, for room occupancy to keep in pace with the tourist growth. Although the Management regularly compares the actual occupancy ratio of individual hotels with the budgeted breakeven occupancy, the absence of target for occupancy as well as long term plan to improve the occupancy indicates the lackadaisical approach of the management in improving the business.

The Management stated (April 2007) that the breakeven occupancy of hotels at Sathur and Pitchavaram exceeded 100 *per cent* due to their uneconomic size, which could not be rectified at this juncture. The reply is admittance of the fact that some of the hotels were set up without ensuring necessity and economic viability. In respect of other hotels, which failed to achieve the desired occupancy level, the Management stated that it had taken up several measures apart from upgradation of the hotels with provision of televisions, generator sets and replacement of worn-out air-conditioners and the occupancy had increased during 2006-07. However, in the context of increase of tourists in the State by 25 *per cent* in 2006-07, the increase in the occupancy from the stagnant level of 49 *per cent* during 2002-06 to 54 *per cent* in 2006-07 is not significant.

Poor maintenance and room services

2.2.11 Reasonably good and economically attractive and efficient tourist friendly services are the basic requirement of hotel industry. Hence, hotels maintain complaints register to ensure prompt addressal of client complaints and improvement in services. The table below indicates the nature of complaints recorded by the tourists in 15 hotels including the restaurant at New Delhi during the period 2002-07.

(In numbers)

Nature of complaint	2002-03	2003-04	2004-05	2005-06	2006-07	Total
Poor maintenance	14	27	23	22	32	118
Poor room service	7	12	8	13	13	53
Poor provision of basic amenities	7	9	8	8	30	62
Poor quality of food	21	24	14	19	2	80

The feed back from the customers on the poor maintenance of hotels and poor room services was on the increase.

It could be seen from the table that the clientele dissatisfaction was due to poor maintenance of rooms, poor service, inadequate provision of basic amenities and poor quality of food, *etc*. The Company, however, did not review such complaints for taking remedial actions. Audit noticed;

- non-replacement of the old air-conditioners in three units (Coimbatore, Kanyakumari and Trichy), non-provision of furniture and interior decoration and non-replacement of the carpets for decades in two units (Ooty and Kodaikanal), and;
- inadequate linen as against the stipulated norm of four set per bed and non-replacement of the old mattress in four units (Kanyakumari, Trichy, Thanjavur and Madurai-II).

It was noticed that the Company required its franchisees to undertake white washing of the buildings once in six months, cement painting once in one-and-half years and enamel paints once in three years. However, no periodical painting/white-washing was undertaken in respect of the hotels operated by the Company for years.

The ratio of total number of personnel employed per room had declined from 0.44 in 2002-03 to 0.39 in 2006-07 against the industry norm of 0.46. Thus, the Company's hotels employed less number of personnel in the lodging sector over the years, which had a direct impact on clientele dissatisfaction.

The Management stated (April 2007) that the customer service would be improved after outsourcing of the "D" category works♣. The replacement of old air-conditioners and up-gradation at a cost of Rs.2.50 crore was carried out in six hotels in 2005-06. Though the Company decided (August 2004) to outsource the housekeeping and catering services, it had not finalised the nature of work and number of employees required for outsourcing so far (September 2007).

Ineffective publicity

2.2.12 The table below exhibits the advertisement expenditure incurred by the hotel division (inclusive of bar, restaurant and boating) *vis-a-vis* the total

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♣ Duties carried out by room boy-cum-waiter, kitchen mate, gardener and watchman, *etc*.

advertisement cost during the period 2002-03 to 2006-07.

Year	(Rupees in lakh)			Percentage of	
	Publicity expenditure of hotels	Total publicity expenditure of the Company	Total expendi-ture of the Company	Total publicity expenditure to the total expenditure (5)=(3)/(4) X100	Publicity expenditure of hotels to the total publicity expenditure (6)=(2)/(3) X100
(1)	(2)	(3)	(4)	(5)	(6)
2002-03	1.15	24.81	3,154.76	0.79	4.64
2003-04	1.35	45.31	3,273.88	1.38	2.98
2004-05	2.79	23.24	3,447.44	0.67	12.01
2005-06	2.52	21.92	3,752.69	0.58	11.50
2006-07	1.84	36.48	4,386.08	0.83	5.04

Source: Annual accounts of the Company.

The expenditure incurred on publicity constituted 0.58 to 1.38 percentage of the total expenditure of the Company.

It could be seen from the table that the expenditure on publicity ranged between 2.98 to 12.01 *per cent*. In fact, the expenditure on publicity of the Company constituted a meagre 0.58 to 1.38 *per cent* of the total expenditure. Lack of visible and aggressive publicity was also one of the reasons for the low level of patronage of general public to the Company's hotels.

The Management stated (April 2007) that in view of huge fixed cost incurred by the Company, the availability of its hotels was also included in the advertisements of the Tourism Department. The reply is not tenable as the advertisement released by the Tourism Department mainly facilitated tourist inflow in the State and did not specifically relate to the Company's hotels.

Performance of catering sector

Absence of favourable mix in food stuff, increased fixed cost coupled with excess food and fuel costs over norms resulted in cash loss of Rs.1.46 crore in 11 to 17 catering units

2.2.13 The details of turnover to cash profit/cash loss in respect of the catering units for the period 2002-07 are given in **Annexure-14**. It could be seen therefrom that 11 to 17 units incurred cash loss of Rs.1.46 crore during 2002-07 despite increase in tourist growth. The cash loss was on the increasing trend from Rs.20.72 lakh in 2003-04 to Rs.31.81 lakh in 2006-07.

The Management stated (April 2007) that the overall loss in catering sector reduced from Rs.1.50 crore *per annum* prevailing prior to 2002-03 to Rs.57.25 lakh *per annum* in 2005-06. The Company attributed the acute shortage of manpower affecting the quality of food as well as customer service as cause for non-achievement of the budgeted income in the catering sector. The Company further stated that with the proposed standardisation of catering service in major hotels and franchising of restaurants, the catering sector could break-even in future. The reply is not acceptable since absence of favourable sales mix in food stuff, increased fixed cost besides excess food

and fuel costs over the norms were the few important reasons for losses in the operation of the catering units.

Food and fuel costs

Ineffective control over the expenditure on food and fuel led to loss of Rs.0.10 crore and Rs.0.48 crore respectively over the budgeted norms.

2.2.14 The Company had fixed (1992-93) norms for food cost at 37 *per cent* of the catering income. The budgeted fuel cost which was reckoned at 8 *per cent* of the catering income till 2002-03 was increased to 9 *per cent* from 2003-04 and further to 10 *per cent* in 2006-07. To keep the expenditure within the norms, the managers of the units were instructed (September 2003) to avoid wastage and idle burning of gas, usage of uncleaned burners, *etc*. Audit analysis revealed that 2 to 12 units exceeded the food cost norm of 37 *per cent* by 0.11 to 41.85 *per cent* and 16 to 24 units exceeded the fuel cost norms by 0.14 to 20.33 *per cent* during the period 2002-07. The ineffective control over the expenditure despite instructions resulted in loss of Rs.10.17 lakh and Rs.48.01 lakh respectively on account of excess food cost and fuel cost over the budgeted norms during 2002-07.

The Management stated (April 2007) that high food cost in some of the units were due to purchase of provisions from super-market instead of open market and absence of favourable sales mix of food stuff. In respect of fuel cost, it was stated that the price of commercial gas cylinder had increased sharply in the past five years but the tariff of food stuff was not increased commensurately in view of stiff competition from the private hotels. The reply is not tenable as the Company started purchasing the provisions from the open market as early as September 2003 and the norms for fuel cost was periodically increased from 8 *per cent* to 10 *per cent*. Failure to enforce strict adherence to the norms led to the loss.

Franchising of the hotels and restaurants

2.2.15 The Company decided (March 1991) to lease out/franchise the hotels, which were incurring cash losses as well as newly constructed hotels, which were *per se* commercially unviable. Accordingly, the State Government permitted the Company to franchise 31 hotels and 10 restaurants between June 1998 and July 2004.

The State Government also directed (June 1998) the Company to fix upset price[•] for franchising these units at 10 *per cent* of the guideline[♣] value of the land and book value of the buildings with annual escalation at 10 *per cent* on compounded basis. The period of franchise was fixed at 10 years in respect of the hotels having five rooms and less and 15 years in respect of the hotels having more than five rooms.

• Upset price is the price below which the franchise could not be engaged.

♣ Guideline value – value of land as fixed by the Sub-Registrar.

The table below indicates the status of the franchising of the units as on 31 March 2007.

Position of the units identified for franchising	Number of hotels/restaurants	Reasons for non-franchising
Idle *ab initio*	3 hotels	Unviable economic operation
Kept idle continuously after termination of franchise	10 (9 hotels and 1 restaurant)	Unfavourable location and unviable economic operation
Operated by the Company	10 (5 hotels and 5 restaurants)	Objected by Forest Department (one hotel); Non payment of land cost to land owner till March 2007 (one hotel); Non fixation of upset price (one hotel); Non matching of upset price (two restaurants); No response to tender (one hotel and two restaurants); and Returned by the franchisee (one hotel and one restaurant).
Franchised	18 (10 hotels, 4 restaurants and 4 hotels let out on rental basis)	---

Source: Information furnished by the Company.

The Company attributed the fixation of upset price at 10 *per cent* of guideline value of the land and of the book value of the buildings with 10 *per cent* escalation *per annum* as the main reason for failure in franchising the hotels. The Company appointed (December 2003) Mahindra Acres Consulting Engineers Private Limited for fixation of the upset price, based on the earning capacity of the units. The firm submitted their report in December 2004. The Company, however, did not accept the upset price suggested in the report on the ground that it did not truly reflect the earning potential of the units. The Company, therefore, recommended (September 2006) to the Government to retain the existing method of fixation of the upset price based on the guideline value and to reduce the rate of escalation to 15 *per cent* once in three years in the franchise fee. This proposal was accepted by the Government in February 2007.

Thus, the Company took three years to decide the upset price and to bring an amendment to the escalation clause in the lease agreement and in the meanwhile, the units could not be franchised. It was observed that out of 13 hotels, the Company could franchise seven hotels so far (September 2007). The remaining six hotels have remained idle (September 2007).

Franchising of hotel at Salem

2.2.16 The Company took possession (1990) of a piece of land from Salem Municipal Corporation (SMC) and constructed a hotel there utilising the

GOI's grant of Rs.33 lakh and Rs.15 lakh from its own sources. The Government directed (March 1992) the Company to pay the cost of land as per the guideline value along with 12 *per cent* interest *per annum* from 1990 to SMC. The amount was to be paid in seven annual installments with a moratorium of two years. The Company requested (October 1997) the Government for waiver of the land cost and did not settle the dues of SMC. In the mean time, it commenced (September 1997) commercial operation of the hotel. The Government turned down (July 2000) the request for waiver of the land cost and directed the Company to pay the land cost along with interest in five annual installments immediately.

The Company, however, did not pay the installments as directed (July 2000) by the State Government immediately. It paid (March 2007) the first installment of Rs.18.91 lakh only. In the mean time, its efforts (October 2002) to franchise the unit (which was incurring losses *ab initio*) did not succeed, as SMC objected to the franchise without settling their dues.

Failure to pay the land cost to SMC deprived the Company from earning revenue of Rs.0.77 crore through franchising.

It was noticed that the Company continued to run the hotel and had incurred operating losses (Rs.2.23 lakh) in the last three years except 2006-07, when it earned operative profit of Rs.1.95 lakh. Thus, failure of the Company to pay the dues of SMC in time despite earning profit deprived it of revenue of Rs.76.96 lakh (worked out on the basis of offer received in October 2002) up to March 2007 through franchising.

The Management stated (April 2007) that it had already floated (March 2007) tenders and was hopeful of franchising at a higher rate than the profit earned by the unit. However, there was no response to this tender and the Company had again floated (July 2007) tender for franchising this hotel. The hotel is yet (September 2007) to be franchised.

Transport division

2.2.17 The transport division of the Company provides transportation facilities to the tourists for visiting various tourist places by operating 19 buses, one tempo traveller and one sumo.

The following table indicates the physical performance of the transport division during the period 2002-03 to 2006-07.

Details	2002-03	2003-04	2004-05	2005-06	2006-07
Number of vans/buses/other vehicle used for tour operation	23	19	20	20	21
Available seat capacity (number of seats per year)	2,11,907	1,86,240	1,84,710	1,86,150	1,85,535
Fleet utilisation (in *per cent*)	70	75	70	71	72
Operated seat capacity for the year on utilised fleet strength	1,48,335	1,39,680	1,29,297	1,32,167	1,33,585

Details	2002-03	2003-04	2004-05	2005-06	2006-07
Sale of package tour tickets converted in seat capacity	81,534	89,993	81,096	85,274	90,818
Percentage of sales against operated capacity	54.97	64.43	62.72	64.52	67.99

Source: Data furnished by the Company.

It may be seen from the table that the actual seat capacity utilised for package tour ranged between 54.97 to 67.99 *per cent* during the period 2002-07 despite the increase in tourist growth. The Management stated (August 2007) that the utilisation of capacity was around 83 to 90 *per cent* from 2004-05 to 2006-07. The reply is not tenable as the higher percentage was arrived based on the number of operated buses and average fleet utilisation. The Company had not considered the un-operated trips/buses due to idling of buses and actual tickets sold converted in seat capacity.

2.2.18 The Company operated 37 types of tour packages covering tourist interest places in Tamil Nadu and the Southern States. Audit scrutiny revealed that 90 to 93 *per cent* of total sales under tour packages were contributed by 14 types of tour packages. The main reason for poor response to other 23 types of tour packages was lack of publicity and awareness among the tourists in other States about the tours being operated by the Company. Out of 14 types of tours, the prime tour was one-day package tour to Tirupathi with Cellar Dharshan, which contributed 28 to 31 *per cent* of the income from the tour packages. Revenue earned from this tour also had gone down in 2005-06 and 2006-07 due to:

- withdrawal of India Tourism Development Corporation's share of 20 tickets per day with effect from March 2006;
- the Company's inability to get the allotment of more than 100 tickets per day for darshan from Tirupathi Devasthanam; and
- competition from tours operated by Andhra Pradesh Tourism Development Corporation Limited, which covers Tirupathi from all other places in Tamil Nadu like Chennai, Erode, Coimbatore, *etc*.

The Management stated (April 2007) that the Company was issuing advertisements and publicity in synergy with Commisionarate of Tourism. Special tours for public sector and IT companies undertaken during 2004-06 resulted in increasing the income. The reply is not tenable as it has been dependant upon one tour package to Tirupathi for revenue. The Company needs to make efforts to increase the response to other tour packages.

Corporate Governance

2.2.19 Corporate Governance is the system by which companies are directed and controlled by the Management in the best interest of the shareholders and ensuring greater transparency and better and timely financial reporting. The BODs are responsible for the governance of their companies.

It was observed that:

- The MDs of the Company were frequently changed by the Government and eight MDs were appointed during the period of review. Frequent change of MDs resulted in delay in taking decision on important issues.
- No meeting of the BOD was conducted with full strength during the review period. One meeting (218th meeting held on 31 March 2006) was deferred due to lack of quorum.
- During the above period, eight Audit Committee meetings were held. The committee comprised of three members including the MD and internal auditors. In none of the meetings, the internal auditors attended in full strength.

Internal Audit

2.2.20 The Internal Audit of the Units of the Company is done by the external agencies. The auditors for undertaking internal audit of the units are selected by calling open tender. The Company selects the Internal Auditors based on their past experience in the similar field and also based on competitive fees quoted. The Internal Auditors are appointed for undertaking internal audit in the units for the specific regions *viz*., Chennai, Northern, Central, South I and South II. The internal auditors are entrusted to conduct (a) proprietary audit, (b) system audit, and (c) management audit. They are directed to give their report on monthly basis to the MD and to Internal Audit Wing of the Company.

Internal Audit reports were submitted by the internal auditors and necessary follow up action were taken by the units and monitored by the internal audit wing of the Company. Further, the internal audit reports were monitored at MD level and discussed at meetings of the Audit Committee periodically. As on 31 March 2007, 868 internal audit objections were pending for compliance. The Board suggested (July 2006) that serious lapses pointed out by the internal auditors should be brought to the notice of the Board in future.

Conclusion

The Company could not achieve its main objective of promoting tourism in the State. The percentage of tourists availing its facilities was negligible. Inadequate infrastructural facilities in the hotels, inadequate manpower, poor room service, poor maintenance, ineffective publicity and poor management were the main reasons for the poor patronage of its hotels by the tourists. In the catering sector, inadequate control over the food and fuel costs resulted in consumption exceeding the norms. The Company failed to fix the realistic upset price for franchising of the hotels in time. This resulted in operation of these unviable hotels by incurring huge cash losses.

Out of 37 package tours operated by the Company, one package tour to

Tirupathi contributed nearly 30 *per cent* of the total revenue from package tours.

Recommendations

The Company should:

- **run its services professionally if it has to get a major share of tourist growth. Its working force has to be given regular orientation training and motivated to perform better. Fact is that most of its properties are in prime locations which are convenient for tourists.**
- **make efforts to increase the occupancy level by improving/upgrading infrastructural facilities and room service of its hotels. If the private sector can do it so can the Company.**
- **make efforts to bring awareness among tourists about its facilities through aggressive publicity.**
- **improve food and room service in the hotels considered economical to be run by the Company.**
- **prepare a time bound frame work to franchise the remaining identified uneconomical units or to close them to prevent further losses from such units.**
- **take steps to increase the response of tourists to all the package tours operated by the Company.**

The matter was referred to the Government in June 2007; and its reply is awaited (September 2007).