



TWELFTH KERALA LEGISLATIVE ASSEMBLY

**COMMITTEE
ON
PUBLIC UNDERTAKINGS
(2008-2011)**

SEVENTIETH REPORT

(Presented on 30th June, 2009)

SECRETARIAT OF THE KERALA LEGISLATURE
THIRUVANANTHAPURAM
2009

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On

**Transformers and Electricals Kerala Limited based on the Reports of the
Comptroller and Auditor General of India for the year ended
31st March 2007 (Commercial)**

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* Resigned from K.L.A. w.e.f. 28-5-2009.

INTRODUCTION

I, the Chairman, Committee on Public Undertakings (2008-2011), having been authorised by the Committee to present the Reports on their behalf, present this Seventieth Report on Transformers and Electricals Kerala Limited based on the Report of the Comptroller and Auditor General of India for the year ended 31st March, 2007 (Commercial) relating to the Government of Kerala.

The Report of the Comptroller and Auditor General of India for the year ended 31st March, 2007, was laid on the Table of the House on 26-2-2008. The consideration of the audit paragraphs included in this Report and the examination of the departmental witness in connection thereto was made by the Committee on Public Undertakings constituted for the period 2006-08.

This Report was considered and approved by the Committee at its meeting held on 13-5-2009.

The Committee place on record their appreciation of the assistance rendered to them by the Accountant General (Audit), Kerala in the examination of the Audit Paragraphs included in this Report.

The Committee wish to express their thanks to the officials of the Industries Department of the Secretariat and Transformers and Electricals Kerala Limited for placing before them the materials and information they wanted in connection with the examination of the subject. They also wish to thank in particular the Secretaries to Government, Industries Department and Finance Department and the officials of Transformers and Electricals Kerala Limited who appeared for evidence and assisted the Committee by placing their considered views before the Committee.

Thiruvananthapuram,
30-6-2009.

MANKODE RADHAKRISHNAN,
Chairman,
Committee on Public Undertakings.

REPORT

TRANSFORMERS AND ELECTRICALS KERALA Ltd.

AUDIT PARAGRAPH

Avoidable expenditure due to injudicious decision

In response to an enquiry made by Bombay Suburban Electric Supply Company Limited [Reliance Energy Limited (REL)], the Company quoted (May 2002) rates for the supply of three classes of transformers with price variation clause as per Indian Electrical and Electronics Manufacturers' Association (IEEMA) formula. Subsequently, as requested by REL, the Company reduced (December 2002) the prices and at the same time made it firm. Accordingly, REL placed (December 2002) letter of intent on the Company for the supply of the three classes (four each) of the transformers at a unit cost of Rs. 4.47 crore, Rs. 1.58 crore and Rs. 1.49 crore respectively and agreement signed (January 2003). The supply was to be completed by January 2006.

At the time of revising the prices, the Company deleted the price variation clause without considering the future increase in material cost as delivery was staggered over three years. Subsequently in view of considerable increase (2.75 to 155.87 per cent) in the material prices the Company requested (February 2005) REL to change the purchase order terms from firm price to variable price as per IEEMA formula, which was rejected (February 2005) by REL. The Company supplied (December 2006) 10 transformers and work on the remaining transformers was in progress (May 2007). The financial implication in respect of all the 12 transformers as worked out by the Company on account of price variation is Rs. 28.15 crore.

Thus, injudicious decision of the Company to keep the prices firm and not protect its interest in a long term contract resulted in avoidable expenditure of Rs. 28.15 crore.

The Management stated (July 2007) that decision to take the order at a firm price basis was correct because price variation on raw materials was marginal during that period. The reply does not hold good since the decision to make the prices firm considering the situations prevalent at the time of taking the order against supply staggered over three years was not justifiable.

The matter was reported to the Government (June 2007); the reply had not been received (August 2007)

[Audit paragraph 4.1 contained in the Report of the Comptroller and Auditor General of India for the year ended 31 March 2007]

The notes furnished by Government on the Audit paragraph is given in appendix II.

1. The Committee enquired about the decision of the company to keep the price firm and non-protection of its interest in a long term contract which caused a loss of Rs.28.15 crore. The witness stated that the order was originally received from Bombay Suburban Electric Supply Company Ltd. when TELK submitted its offer in 2003 and later the Company was taken over by Reliance Energy Limited (REL). He added that at the time of tender the price was fixed without any price variation clause and there was no provision for price variation in the order and the Audit's objection is based on opportunity cost. The Principal Secretary, Industries Department stated that as there was no price variation clause in the tender, the Company had only two options-to quote for it accepting their conditions, or not to quote at all. The witness stated that the Company quoted with price variation before accepting the order, but that had to be withdrawn after negotiation.

2. When the Committee pointed out the Audit remark of price variation in the tender condition, the witness responded in the negative and stated that tender was finalised on fixed price basis. The Principal Secretary, Industries Department informed that as far as TELK was concerned it was a big order of Rs.33 crore for the company with a turn over of Rs. 80-82 crore and it was essential for the survival of the company. The company had sufficient capacity and workers were without work at that time. Over and above this the company could get 50% advance payment. He added that it was a trying time for the company as other companies were not giving orders saying that it is a BIFR company and banks refused to give loans for working capital needs. The Company had rotated the money obtained through this order to execute small orders and made profit out of it. To the Company, the entry obtained was useful for its future by enabling to establish credibility. He added that the company owes its profitable position to the risk taken by the company in taking this order.

3. The Managing Director stated that the cost as per the document prepared by TELK to argue with the Company about the magnitude of the losses that TELK would have to bear was the opportunity cost taken into account by Audit. It was only prepared to show the magnitude of the opportunity cost which has nothing to do with actual cost. The witness stated that if the company was financially stable it would be able to quote fixed price and buy the raw materials needed at once giving no scope for price variation

and subsequent loss. If the company was that much financially sound, it would have been able to make profit. Nevertheless the company could establish its credibility, though a small delay had occurred in the delivery of the product and it helped the company to make profit in succeeding years.

4. The Committee stated that as per the observation of Audit all the agreements which have time span of more than one year for delivery of goods should be on price variation condition. The Principal Secretary, Industries Department stated that the company did not have the financial stability to buy the raw materials needed in advance anticipating price rise and therefore cost escalation had affected the Company. The Committee accepted the business strategy adopted by the company involving risk for the future benefit of the company but pointed out that a loss of Rs. 28 crore had occurred in the deal. The witness stated that the loss of Rs. 28 crore projected by Audit was only based on opportunity cost. The real loss sustained to the company was much less. He admitted that when the contract is spread over a 3 year period and quoted with price variation, it should be loaded into the tender and then quoted for the future also. But in this case, during the time of this order, as the Company was having a turn over of Rs. 80 crore, it rotated the money and made a profit of Rs.1.7 crore since March 2006. The Principal Secretary admitted that the exact calculation of the loss was not made in this case.

5. The Committee directed that actual figure of loss should be calculated and details submitted to the Committee. The witness agreed to calculate the loss and submit the same to the Committee. The Committee wanted to have a detailed report on the real loss which occurred in the deal. The witness informed that the Company is now insisting on price variation clause in its agreements.

Conclusion/Recommendation

6. **The Committee finds that the decision of the Company to keep the price firm for an order, against supply staggered over three years is unjustifiable and against the interest of the Company. The Committee accept the company's contention that it was done as part of the business strategy adopted by the company involving risk for future benefit, as the company was undergoing a trying time having enough capacity and staff without any work. Over and above this, the Company would be able to establish credibility. However the Committee express its grave concern over the huge loss sustained to the Company in a single deal. Since the Company insists that the loss of Rs. 28 crore projected by Audit is only based on opportunity cost, the Committee recommends that the actual loss that occurred in the deal be calculated and submitted to the Committee. The Committee further recommends that the price variation clause should be included in all agreements with staggered delivery schedules.**

AUDIT PARAGRAPH

Avoidable extra expenditure due to incorrect bidding

The Company submitted a bid (May 2000) in response to the tender invited by the Kerala State Electricity Board (Board) for the up gradation of substations and construction of transmission lines on 'turnkey' basis. The scope of the work included construction of 35.5 Km of 110 KV DC line along the existing 66 KV DC line route.

As per the tender conditions, the bidder had to submit a priced activity schedule along with the bid by duly recording the rates and prices for all items of the works. The tender conditions also provided that the rates quoted for all civil/electrical works shall include cost of materials. It was also stated that items not indicated in the schedule but required for the fulfillment of the contract shall also be deemed to have been covered by the rates and prices in the activity schedule, for which no additional payment will be made to the contractor. Moreover, the necessity for inclusion of cost of tower structure was also reiterated by the Board prior to submission of the bid. Despite this, while preparing the price schedule, the Company omitted the cost of tower structures required for the line works and the total contract price was worked out as Rs. 14.72 crore. The Board awarded (July 2000) the work to the Company since it emerged as the lowest bidder after under quoting by excluding the cost of materials amounting to Rs. 2.19 crore. But for this under quoting the Company would have emerged as the third lowest tenderer.

During execution of the work, the Company procured (June 2001-December 2004) 531 MT of tower structures for the installation of 35.5 Km of transmission line by incurring a total expenditure of Rs. 2.19 crore. The Company intimated (June 2005) the Board that due to some misunderstanding at the tendering stage, the cost of tower structure had been omitted to be included and requested for compensation. The Board had not responded to the request of the Company and its subsequent reminders (July 2007). The expenditure of Rs. 2.19 crore incurred for the procurement of tower materials would not be recoverable from the Board by virtue of the provisions of the turnkey contract resulting in avoidable extra expenditure of Rs. 2.19 crore.

The matter was reported to the Management/Government (April 2007); their replies had not been received (August 2007)

[Audit paragraph 4.2 contained in the Report of the Comptroller and Auditor General of India for the year ended 31 March 2007]

The notes furnished by Government on the Audit paragraph is given in Appendix II.

7. The Committee found that an extra expenditure of Rs. 2.19 crore was incurred by the company for the procurement of tower materials for the tower structures owing to the non inclusion of their cost in the tender and enquired about the same. The witness stated that the Company took the order for the turnkey project in May 2000 for Rs.14.72 crore. But the Company estimated the cost of erection of tower without including the cost of the materials as there was no clarity in the order which stipulated erection of tower instead of 'supply and erection'. But when the tender was opened the company realised that the material for the construction of the tower should also be included. Though a mistake had occurred there was enough margin to execute the contract. Therefore the company quoted the price and was accepted. The witness stated that owing to the cost over run the extra cost for the tower could not be absorbed and thus loss occurred. To another question the witness replied that at that time, if the cost of the materials for construction of tower structure was included, the company would not have got the contract. The company needed this order to stay afloat as KSEB would make advance payment. Moreover it was a new field and the company was expecting more orders from KSEB in future. Taking all these into consideration, the company had not increased the bid amount.

8. The Committee observed that the company had suffered a loss instead of profit in the work and enquired the present financial position of the company. The witness stated that the company is now running on profit and have tied up with NTPC. After the tie up, the company is making profit. The Principal Secretary informed that if the momentum of progress is continued the company will become the biggest public sector undertaking in the State and that there was a profit of Rs. 9.15 crore in the previous year.

Conclusion/Recommendation

9. **The Committee finds that the company suffered a loss of Rs. 2.19 crore consequent on the non inclusion of the cost of the materials for the construction of tower in the tender. The Committee observes that it points to the inefficiency and carelessness of the officials of the company who prepared the estimate because the Board had reiterated the necessity for inclusion of the cost of the tower structure, prior to submission of the bid. Therefore the Committee recommends to take stringent action against those who were responsible for the loss.**

MANKODE RADHAKRISHNAN

Thiruvananthapuram,
30-6-2009.

*Chairman,
Committee on Public Undertakings.*

APPENDIX I

Summary of Main Conclusions/Recommendations

<i>Sl. No</i>	<i>Para. No</i>	<i>Department Concerned</i>	<i>Conclusins/Recommendations</i>
1	6	Industries	The Committee finds that the decision of the Company to keep the price firm for an order, against supply staggered over three years is unjustifiable and against the interest of the Company. The Committee accepts the company's contention that it was done as part of the business strategy adopted by the company involving risk for future benefit, as the company was undergoing a trying time having enough capacity and staff without any work. Over and above this, the company would be able to establish credibility. However the Committee expresses its grave concern over the huge loss sustained to the Company in a single deal. Since the Company insists that the loss of Rs. 28 crore projected by Audit is only based on opportunity cost, the Committee recommends that the actual loss that occurred in the deal be calculated and submitted to the Committee. The Committee further recommends that the price variation clause should be included in all agreements with staggered delivery schedules.
2	9	„	The Committee finds that the company suffered a loss of Rs. 2.19 crore consequent on the non inclusion of the cost of materials for the construction of tower in the tender. The Committee observes that it points to the inefficiency and carelessness of the officials of the company who prepared the estimate because the Board had reiterated the necessity for inclusion of the cost of the tower structure, prior to submission of the bid. Therefore the Committee recommends to take stringent action against those who were responsible for the loss.

APPENDIX II

Notes furnished by Government on Audit Paragraphs

<i>Sl. No</i>	<i>Para. No</i>	<i>Action Taken Notes</i>
(1)	(2)	(3)
1	4.1 (A.R. 2006-07)	<p>4.1 It is the option of the customers to float tenders either at firm price or with price escalation. The transformer industry was facing heavy competition and the company should have presence in the market and hence it was in the best interest of the company, it took this high value order on firm price basis after giving due consideration for normal price increase expected within the period of scheduled execution. Also, the company was so vigilant to maintain the order book to a satisfactory level. Moreover TELK was passing through very difficult phase during the period and booking a bid order like this, which offers almost 50% interest free advance amounting to Rs. 16 crores, was felt very much essential for the survival of the company. Also, the company was trying for a turn around and cash in flow was highly needed to feed production to achieve the targets.</p> <p>Apart from the above, since the contract was a deemed export one, the company could also avail the deemed export benefits and could import the major materials against duty free license.</p> <p>Due to the staggered delivery schedule of the equipments, company started supply by October 2003, after getting the necessary approval from its customer/ultimate customer M/s. NPCIL. However, since December 2004, the raw material price had an abnormal hike resulting in rise in the price of transformers. Noting this fact into consideration, the company immediately took up the matter with M/s. REL & NPCIL suitably for admitting price variation and discussion with higher ups were held seriously in many times for the same. M/s. NPCIL had taken up this issue with the Government of India for passing on PV to the suppliers. But so far a positive reply in the matter has not been arrived at. In April 2007, top officials headed by the CMD visited both REL & NPCIL to discuss the issue and M/s. REL had informed their inability to consider PV due to the fact that they are executing this contract to the ultimate customer also on firm price basis.</p>

(1)	(2)	(3)
		<p>However, M/s. REL had promised that in the event of NPC change their stance in the matter after securing approval from the Government of India, the PV would be passed on to TELK also.</p> <p>As stated above, the company was reeling under heavy financial crisis and the management was on the look out of strategies for a turn around. The maximum cash inflow was the major thrust of the management for the turn around strategy. As such the advances received from the customer was also utilized for procurement of raw materials etc. for other jobs of which the cycle time for cash realization was very less. The effort of the management in this line was very successful and resulted in high operating level and the consequent increase in profitability. The effect of cash loss for 3 transformers of this particular order as per audit observation was very much less when compared to the gain on execution of other orders in time and increase in operating level.</p> <p>The last 1 No. 260 MVA GT to the RAPP 5 & 6 project was supplied March 2008. In this connection, based on the Company's request, M/s. REL has advanced Rs. 1.61 crores again (without any interest) for procuring CRGO, in the form of L/C favouring the supplier. The interest free advance amounting to Rs. 16 crores already released in the initial stage and the subsequent financial assistance in the form of LC amounting to Rs. 1.61 crores now etc. would compensate the loss to some extent.</p> <p>It is again submitted that the decision taken by the TELK management at that time was a conscious decision to have a very heavy advance which would be pumped in to the working capital stream of the Company which was struggling for making both ends meet. It may please be noted that major portion of the working capital was eroded due to the heavy losses incurred by the Company in yester years.</p> <p>Even though the company offered for firm price and taken 50% advance from REL when the consortium banks were very reluctant to enhance the working capital limits, it was at the best</p>

(1)	(2)	(3)
		<p>interest of the company, the marketing department very seriously made an attempt to take M/s. Reliance Energy in to confidence by informing them the gravity of abnormal price increase of raw materials and components during the period of supply by making internal calculations. The customer have agreed to take up the matter with the ultimate customer M/s. MPCIL and also agreed to pass on such benefits if received from M/s. NPCIL. It is based on this work sheets, the audit observed and quantified the above loss.</p> <p>Rs. 28.15 crores stated as avoidable expenditure is the difference in the realizable amount if the contract were with price variation and also price variation is reckoned based on the delivery date. The fact is that this is a firm price contract and the opportunity of price variation was not existing. Also, it is to be stated that in case of contracts with price variation, price variation is normally reckoned based on the contractual delivery date on actual delivery date whichever is economical to customer. In cases where delivery is delayed, the PV claim will be allowed on dates when the customer need to pay less. The above amount is based on notional computation reckoning actual delivery date for price variation calculation when the price was on upward trend.</p> <p>TELK being a manufacturing unit competing in the power sector with giants like BHEL, ABB, SIEMENS, AREVA, CGL etc., it may become necessary to opt for firm pricing with some cushion for price escalation to keep on in the market which may sometime lead to a loss also. The company cannot just discard any contract with firm pricing, as there always exist a business risk in this field.</p> <p>In the light of such experiences, the company is now preferring contracts with price variation clauses. Avoiding the firm price contract segment is dictated by the order position, cash position and the competitive market where BHEL, ABB, AREVA, etc., are being participated. In such cases, the company is more vigilance in quoting firm price contracts and taking utmost care for giving enough cushion for more than normal increase in materials.</p>

(1)	(2)	(3)
2	4.2 (A.R. 2006-07)	<p>4.2. The Company submitted offer on 30-5-2000 against Kerala State Electricity Boards Bid dated 24-4-2000 for Substations and Transmission Projects in Thiruvananthapuram District. The letter of Acceptance for the Turnkey Project including supply of TELK make 10 MVA and 16 MVA Transformers were issued by KSEB on 30-6-2000 with an order value of Rs. 14,71,86,626. The work order No. CE/SSTLC/13/2000-01 was issued by KSEB on 12-7-2000. The audit observation is that the Company's omission to include the cost of tower structure resulted in extra expenditure of Rs. 2.19 crores. In this connection, it is submitted as follows.</p> <p>The Company, while preparing the offer, included only erection charges and cost of accessories like danger/number plates etc. In the description of items, in the bid document "erection of tower super structure was mentioned instead of the usual terminology "supply and erection of tower super structure". It was subsequently understood that on a query of M/s. Andrew Yule and Company which also participated in the tender, M/s. KSEB stated in Andrew Yule's letter itself that the erection includes supply also and a copy of that message was faxed to TELK also which was unnoticed before submission of the offer. However, this was noticed by the company before accepting the work order issued by M/s. KSEB. But the company, even though, was free to accept or regret, decided to accept the order on the following grounds.</p> <p>(a) The order balance with the Company as on 31-3-2000 was only Rs. 60 crores. The Company had to have enough orders to cater the production needs. The management was very cautious of avoiding stoppage of operation of the company due to non-availability of orders. This was a time when State Electricity Boards and other power utilities were shifting to turnkey jobs. The demand for transformers were met by the customers by including the supply of transformers also in the turnkey package. Since the company could not participate in such bids due to lack of expertise and were not qualified in certain cases since having no proven experience in executing such turnkey projects. It was the need of that time to enter into turnkey jobs</p>

(1)	(2)	(3)
		<p>for existence in the market. Being a very prestigious job of the Kerala State Electricity Board, the Company accepted the order on the hope of managing to complete the whole work with the amount quoted. Also, such experience in turnkey sector will definitely keep the door open to TELK for other major jobs outside the state which was highly essential in the changing scenario of executing jobs on turnkey basis in the power sector also.</p> <p>(b) During the period the Company was operating at heavy losses and the operating level was very low. The working capital was eroded and also the Banks were not enhancing working capital limits in spite of the company's repeated request. The unhealthy competition by new entrants in the Transformer industry was also there during that period. The only alternative before the company for survival was to enhance the operating level and manage with low margin on individual orders.</p> <p>It was at this juncture, the company decided to take the particular order which offered 15% advance payment for meeting its requirement of enhanced operating level and requirement of working capital.</p> <p>However, in the light of the issue, the company is now making all precautions to avoid recurrence of such events in future.</p>