



TWELFTH KERALA LEGISLATIVE ASSEMBLY

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

EIGHTY THIRD REPORT

(Presented on 16th March 2010)

SECRETARIAT OF THE KERALA LEGISLATURE
THIRUVANANTHAPURAM
2010

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On

**Kerala Electrical and Allied Engineering Company Limited based
on the Report of the Comptroller and Auditor General of
India for the year ended 31st March 2007 (Commercial)**

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Smt. L. Sailaja, Under Secretary.

INTRODUCTION

I, the Chairman, Committee on Public Undertakings (2008-2011), having been authorised by the Committee to present Report on their behalf, present this Eighty-third Report on Kerala Electrical and Allied Engineering Company 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 31 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 years 2006-08.

This Report was considered and approved by the Committee at the meeting held on 7-10-2009.

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 Kerala Electrical and Allied Engineering Company 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 the Kerala Electrical and Allied Engineering Company Limited who appeared for evidence and assisted the Committee by placing their considered views before the Committee.

MANKODE RADHAKRISHNAN,

Thiruvananthapuram,
16th March 2010.

*Chairman,
Committee on Public Undertakings.*

REPORT

KERALA ELECTRICAL ALLIED ENGINEERING COMPANY LIMITED

AUDIT PARAGRAPH

Avoidable loss due to incorrect estimates

The company had an accumulated loss of Rs. 61.78 crore as on 31 March 2003. For supply of distribution transformers to Government Departments and Public Sector Undertakings, the policy followed by the Company was to quote rates covering full material cost, finance charges and contribution.

The Company submitted (January 2003) quotation in response to a tender floated by Tamil Nadu Electricity Board (TNEB) for the supply of 590 numbers of 500KVA distribution transformers and the quoted ex-works price was Rs. 1.35 lakh per transformer. As per the tender conditions the rates quoted were firm and valid for one year from the date of receipt of letter awarding the contract. The Company received (March 2003) orders for the supply of 590 distribution transformers within a period of one year.

It was noticed that the ex-works rate of Rs. 1.35 lakh per transformer quoted by the Company included raw material cost of Rs. 1.15 lakh. But the cost of raw material actually estimated before submission of tender was Rs. 1.29 lakh. Quoting the price of transformer without covering estimated raw material cost was not in consonance with the policy of the Company and was also not justifiable in view of its poor financial position. The supply was completed (October 2004) with the actual cost of raw material per transformer going up to Rs. 1.34 lakh involving and additional expenditure of Rs. 29.50 lakh with reference to the estimated cost (Rs. 1.29 lakh). The amount of raw material cost short recovered due to initial under quoting worked out to Rs. 82.60 lakh (Rs. 14000 X 590). Further in view of the delay (March to October 2004) in delivery of transformers TNEB withheld an amount of Rs. 36.30 lakh.

Thus, the company's failure to include the correct estimated raw material cost in the price quoted in response to the tender and delay in delivery of transformer resulted in avoidable loss of Rs. 1.12 core.

Management's reply as endorsed by the Government, stated (July 2007) that the Company switched over from superior quality of raw materials to standard quality and thereby reduced the estimated cost of raw material from Rs. 1.28 lakh to Rs. 1.15 lakh so as to quote very competitive rate to bag orders from TNEB for avoiding idling of the work force. It was also stated that even considering a raw material cost of Rs. 1.28 lakh per transformer as per the original estimate, a contribution of Rs. 5105 per transformer was available. The

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reply is not tenable since there was no change over from the superior quality to standard quality at the time of bid as evident from company's subsequent correspondence with TNEB. Moreover, the price of steel adopted (January 2003) by the Company in the preparation of original raw material cost was lower than that in the price data prepared by the Indian Electrical and Electronics Manufacturers' Association (IEEMA) thereby leading to under estimation of raw material cost.

[Audit Paragraph 4.10 contained in the Report of the Comptroller and Auditor General of India for the year ended 31st March 2007.]

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

The Committee pointed out that the company had failed to include the correct estimated cost of raw material in the price quoted in the tender for the supply of 590 distribution transformers and also delayed the delivery which resulted in avoidable loss of Rs. 1.12 crore and wanted to have an explanation from the witness. The witness explained that it was an order from Tamil Nadu Electricity Board (TNEB) for 500 KVA transformers and the audit objection was that a loss of Rs. 1.12 crore had occurred in the deal. The tender was accepted for Rs. 1,35,000 per transformer and at the time of tender Rs. 1,15,000 was taken as material cost. Audit's contention was that though the original estimate was for Rs.1,29,000, eventually it was reduced to 1,15,000. Later, the cost of materials had gone up to Rs. 1,34,000 and thereby the company incurred a loss in the deal. Even according to the price data prepared by the Indian Electrical and Electronics Manufacturers' Association (IEEMA) the material cost adopted by the company was less. The witness stated that Rs. 1,29,000 was the cost estimated by the design department who always estimated on the higher side in order to be safe. But at the time of decision taken by the Management, they have to take an optimum design acceptable to the consumer and that was why Rs. 1,15,000 was taken as estimate for material cost. Regarding the second objection raised by audit that the cost of material had gone up to Rs. 1,34,000 and if Rs. 1.29 lakh was quoted, there would not be much loss, the witness stated that at that time KEL was having a trying time with no orders on hand and having no capacity utilisation and the company's objective was to get maximum orders from Tamil Nadu Electricity Board quoting the most competent price. The company had to cover the variable cost as far as possible and consider the contribution towards fixed cost, for the survival of the company. The witness explained that at the time of quoting Rs. 1.15 lakh as material cost, the company expected a considerable contribution towards fixed cost. For instance, the witness stated that the price of a material used for lamination seal

called CRGO for ensuring assured quality was Rs. 71/Kg which was re-estimated at Rs. 60/Kg since there was no need for such a high quality material and the company could purchase it at Rs.56/Kg. Therefore there was no mistake in the assumption of Rs. 1,15,000 for material cost. The first lot of the order was executed in March 2003 and despatched in May 2003. The material cost at that time was below Rs. 1.15 lakh. But the material cost unexpectedly increased substantially and went up to Rs. 1.34 lakh per transformer. The unexpected rise in the price of material affected the whole industry. The witness informed that at that time KEL was the only supplier for the TNEB. Since the rise in price affected all the suppliers, all the companies including KEL took up the matter with TNEB and changed from firm price situation to that of price variation system. Regarding Audit's observation of IEEMA price, the witness stated that even now material cost is below the IEEMA price. The witness stated that the company had supplied the transformers incurring loss. But the supply could help the company to maintain its credibility later and could avoid being black listed by TNEB and the company again got orders for 500 KVA transformers. In 2004 and 2006 more orders were received. The witness added that the Mamala unit of the company is running without any problem owing to the major order of Rs. 14 crore received from TNEB. He further informed that now for each 500 KVA transformer, the company was getting about 18% margin. The Committee observed that as far as the business strategy of the company was concerned the action of the company may be correct. When the Committee enquired why the company slipped into loss even though it got the materials at lower prices. The witness explained that the supply had to be effected in one year and the price of the materials increased substantially after the original decline.

2. When the Committee enquired why the Department had delayed in replying to the audit paragraph, the witness stated that the company had responded to it but when it was processed delay had occurred. The most reliable proof was that the product had been accepted. When the Committee enquired whether all the orders of KSEB is received by the Company, the Managing Director stated that most of the orders of KSEB is given to the Company. KSEB gives its orders to the company because of the higher quality of its products even though they are priced higher. On enquiring whether KSEB is giving orders to other companies too, the witness stated that as per business prudence, in order to avoid monopoly and to ensure competition, every company seeks alternate suppliers.

3. The Committee enquired why KSEB was not giving orders to the company now. The witness stated that tender has to be called for by KSEB and the company is ready to supply the items even in advance. When enquired about

the present condition of Edarikkodu unit of the company, the witness informed that the unit was half finished in 1991 but not much work was done there up to 2007-08. Now efforts are going on to use it as a feeder unit utilising the assets. The winding of the brushless DC fans for use in trains, produced in the Kundra unit is being done there. Due to lack of staff, Kudumbashree personnel are being trained to do it. The witness disclosed that as there is not much production, it is not proper to recruit new employees and therefore the company did not go for new recruits. The witness added that it is a unit to produce alternators for automobiles and it was a failure due to various factors. When the Committee enquired whether the amount withheld by the TNEB had been recovered, the witness stated that no amount was lost owing to the inaction of the company.

Conclusion/Recommendation

4. The Committee finds that the company's under estimation of raw material prices without taking into account of the bullish trend in the prices of commodities pertaining to the tender for the supply of 590 distribution transformers and the delay in its delivery caused a loss of Rs. 1.12 crore. The Committee recommends that the company should be vigilant to assess the commodity market trend before purchasing bulk quantities and action should be taken to avoid such delay in delivery of transformers which leads to heavy loss to the company.

MANKODE RADHAKRISHNAN,

Thiruvananthapuram,
16th March 2010.

*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>Conclusion/Recommendation</i>
(1)	(2)	(3)	(4)
1	4	Industries	The Committee finds that the company's under estimation of raw material prices without taking into account of the bullish trend in the prices of commodities pertaining to the tender for the supply of 590 distribution transformers and the delay in its delivery caused a loss of Rs. 1.12 crore. The Committee recommends that the company should be vigilant to assess the commodity market trend before purchasing bulk quantities and action should be taken to avoid such delay in delivery of transformers which leads to heavy loss to the company.

APPENDIX II

Note furnished by the Government on audit paragraph

(1)	(2)
4.10	<p>The Company has switched over from Superior quality raw materials to standard quality sufficient to meet TNEB specification and to make the offer competitive. The price of Steel (CRGO) was taken as Rs. 60 per kg. in the revised estimate. The revised estimates was prepared on the basis of feed back received from the suppliers that the steel price wsas showing a downward trend.</p> <p>For Transformer tank manufactured using MS plate (Structural Steel) the price taken in the estimate was Rs. 38 per kg. including fabrication cost.</p> <p>The quality of the materials used in the transformer and the performance are accepted by the customer (TNEB) based on testing of the transformers by their representatives who have visited the factory and examine the quality and conduct testing of each trnasformer.</p> <p>The price indication IEEMA Circular is being considered only for calculating the variation in price of Transformer of each month. Even now the company is procuring steel (CRGO) at a price lower than that mentioned in the IEEMA Circular.</p> <p>While quotating to TNEB during January 2003. The company had have taken a very competitive price to become the lowest bidder in the tender to get the full tendered quantity to avoid the idling of work force and to increase the turnover.</p> <p>Considering explanations given above, the Audit para may kindly be excluded from the Audit Report (Commercial) for the year 2007-08.</p>