

**PUBLIC ACCOUNTS COMMITTEE
(1977-78)**

(SIXTH LOK SABHA)

EIGHTY-FIRST REPORT

DEFENCE SERVICES

MINISTRY OF DEFENCE

[Paragraphs 9 and 11 of the Report of the
Comptroller and Auditor General of India for the
year 1975-76, Union Government (Defence Services)]



Presented in Lok Sabha on 27th April, 1978

Laid in Rajya Sabha on 27th April, 1978

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April, 1978/Vaisakha, 1900 (S)

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<u>Page</u>	<u>Para</u>	<u>Line</u>	<u>For</u>	<u>Read</u>
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PART II*

Minutes of the sittings of PAC held on :

24-2-1978 (A.N.)

25-2-1978 (F.N.)

25-4-1978 (A.N.)

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(1977-78)

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(iv)

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3. Shri Bipin Behari—*Senior Financial Committee Officer.*

***Ceased to be Members of the Committee consequent on retirement from Rajya Sabha
w.e.f. 9-4-1978.

INTRODUCTION

1. I, the Chairman of the Public Accounts Committee, as authorised by the Committee, do present on their behalf this Eighty-first Report of the Public Accounts Committee (Sixth Lok Sabha) on paragraphs 9 and 11 of the Report of the Comptroller and Auditor General of India for the year 1975-76, Union Government (Defence Services).

2. The Report of the Comptroller and Auditor General of India for the year 1975-76, Union Government (Defence Services) was laid on the Table of the House on 2nd July, 1977. The Public Accounts Committee (1977-78) examined these paragraphs at their sittings held on 24 February, 1978 (AN) and 25 February 1978 (FN). This Report was considered and finalised at their sitting held on 25 April, 1978 (AN) based on the evidence taken and further written information furnished by the Ministry of Defence (Department of Defence Production). The Minutes of the sittings form Part II* of the Report.

3. A statement containing conclusions/recommendations of the Committee is appended to this Report. For facility of reference these have been printed in thick type in the body of the Report.

4. The Committee place on record their appreciation of the assistance rendered to them in the examination of the Audit Report by the Comptroller and Auditor General of India.

5. The Committee would also like to express their thanks to the officers of the Ministry of Defence (Department of Defence Production) for the cooperation extended by them in giving information to the Committee.

NEW DELHI;
April 26, 1978

Vaisakha 6, 1900 (S)

C. M. STEPHEN,
Chairman,
Public Accounts Committee.

*Not printed. (One cyclostyled copy laid on the Table of the House and five copies placed in the Parliament Library).

REPORT

EXPORT OF DEFENCE STORES

Audit paragraph

1.1. With a view to utilise spare capacity in the ordnance factories and to earn foreign exchange, the Ministry of Defence decided to promote the export of some specific items of equipment and stores on a commercial basis. Accordingly, in February, 1973, a special cell was set up in the Ministry of Defence (Department of Defence Production) to handle the export orders.

1.2. While no formal procedures were laid down for dealing with such transactions until July, 1975, in September, 1973, in a high level meeting in the Ministry of Defence it was decided that:

—while agents could be appointed to explore the market, the final deals would be on a Government-to-Government basis, and stores in all cases despatched direct to the Government concerned;

—agents' commission upto 5 per cent of the f.o.b. price could be paid without the concurrence of the Ministry of Finance (Economic Affairs Department); commission beyond 5 per cent would require specific approval of the Ministry of Finance.

1.3. For transactions negotiated through agents, an 'end user certificate' was normally insisted upon. (The 'end user certificate' is a written affirmation from the foreign Government that the stores are intended for its own exclusive use and would not be sold, transferred or diverted without the seller's prior permission.) Such certificates are verified to ensure that they are genuine and authentic.

1.4. On an enquiry received in June, 1975 from an Indian firm for the export of certain equipment, the Ministry of Defence quoted a price of Rs. 900 per unit, f.o.b. At the request of the firm the unit price was reduced—by 5 per cent—to Rs. 855.

1.5. Further negotiations were conducted abroad (July, 1975) by the Ministry's representative with a foreign firm purporting to represent a foreign Government. During these negotiations the unit price was reduced initially to Rs. 775 if the order was for 50,000 units and Rs. 700 if the order was for 1,00,000 units and, later, to Rs. 710 (i.e. a reduction

of 21 per cent) irrespective of the size of the order. There was no consultation with the Ministry of Finance (Defence) earlier or at this stage. On the basis of an 'end user certificate' produced by the firm, agreement was also reached on the ultimate buyer—foreign Government 'A', subject, however, to scrutiny, acceptance and confirmation from India. It was further agreed during these negotiations that:

- the shipping documents would be sent direct to the foreign Government, but not the priced invoices;
- the transaction would be with the firm who would, in turn, quote its own price to the foreign Government.

1.6. On scrutiny, the 'end user certificate' was found to be unacceptable and the firm was asked to submit a proper and acceptable certificate along with the formal order for the stores.

1.7. On 21st July, 1975, a formal order was received from the firm for 35,000 units of stores (later increased to 50,000 units in August, 1975) without the requisite 'end user certificate' for any indication of the ultimate buyer—the foreign Government.

The order stipulated, *inter alia*, that:

- all payments would be made in Indian rupees acquired through a convertible currency;
- shipping would be arranged by the firm;
- the requisite 'end user certificate' would be submitted by the firm while opening the letter of credit.

1.8. On 23rd August, 1975 an 'end user certificate' was received from the firm emanating from foreign Government 'B' which had not figured in the earlier negotiations. A delegation of foreign Government 'B' happened to be visiting India (Ministry of Defence) at about the same time and stated, when consulted, that it was not aware of the requirements of the stores indicated in the 'end user certificate'.

1.9. Meanwhile, a detailed procedure was prescribed (31st July, 1975) by the Ministry of Defence which enjoined, *inter alia*, that the Ministry of Finance (Defence) would be consulted in regard to the contractual provisions for prices, terms of payment, deliveries etc. The prices were to be determined with reference to the current estimated cost of production with specific additional provisions for material and labour escalation, element of profit etc.

1.10. The concurrence of the Ministry of Finance (Defence) was in this case sought/obtained, *ex-post-facto*, on 26th/28th August 1975 to a unit price of Rs. 710 f.o.b. on the basis of cost data of the basic equipment (without accessories). It was stated that supplies would be delivered ex-stock and the stocks would be replenished through subsequent manufacture.

1.11. On 27th August 1975 a letter of credit for Rs. 2.49 crores (in Indian Rupees) was established by the foreign firm's bankers with an Indian bank and the stores (35,000 units along with accessories) were despatched in September 1975 in a vessel chartered by the firm. According to instructions issued by the Ministry of Defence, although the stores had been issued to foreign Government 'B', the bill of lading was to indicate the foreign firm's bank as the consignee.

1.12. In October 1975, the Military Adviser to an Indian Mission abroad reported that the shipment purporting to have been despatched to foreign Government 'B' was intended for and had in fact been despatched to another destination. Later, in May, 1976, the firm held that as the buyer of the stores from the Ministry of Defence, it had the right and option to re-sell (or sub-divide) the stores to any other customer(s).

1.13. The case reveals :

- that the contract was concluded with a private foreign firm, instead of the ultimate buyer (foreign Government);
- an understanding was reached with the firm that prices would not be revealed and that the firm would be free to quote its own price to the foreign Government;
- although the initial 'end user certificate' furnished by the firm was found to be unacceptable, the genuineness of the second 'end user certificate' was not established before the despatch of stores;
- no steps were taken to ensure that the stores reached the intended destination; copies of shipping documents were also not despatched to the specified foreign Government until 4 weeks after the despatch of stores.

Besides,

- accessories of the value (at cost) of Rs. 8.90 lakhs had been supplied though these were not taken into account in the cost data on which the price was deemed to have been based;
- the manufacture of the basic equipment alone (for replenishment of stocks) would, on the basis of the estimated cost of

manufacture for 1976-77, involve an additional expenditure of Rs. 41.66 lakhs.

The Ministry of Defence stated (March 1977) that:

- the 'end user certificate' was only intended as a safeguard and the same was not verified or got authenticated as there was not doubt about its authenticity;
- all contracts were on f.o.b. basis and there was no requirement to ensure that the stores reached the correct destination and that—
- there was no requirement that the priced invoices should be sent to the foreign Government.

[Paragraph 9 of the Report of the Comptroller & Auditor General of India for the year 1975-76, Union Government (Defence Services)]

NOTE : For facility of reference, certain terms used in the audit para had been referred to in the succeeding paragraphs of this Report as under :

As per Audit Para

'a foreign Government'	. . . . .	foreign Government 'A'
'foreign Government 'A''	. . . . .	foreign Government/ country 'B'
'foreign Government 'B''	. . . . .	foreign Government/country 'C'
'another destination' (of Para 1-12- of this Report)	. . . . .	foreign Government/country 'A'
'foreign firm ' or 'firm '	. . . . .	'Agent'

1.14. The paragraph reveals some glaring deficiencies and deviations from the prescribed practice in the matter of export of defence hardware through an Agent. Broadly, the facts are that initially, the Agent wanted to negotiate the export deal for country 'A' but that was not followed, as the country was not acceptable. Thereafter, the Agent negotiated the deal for country 'B' on the production of an end user certificate from that country, but this certificate was rejected because it was not signed at the required level. Finally, the export deal was finalised for country 'C' and the goods were purportedly shipped for country 'C' but did not reach there and actually reached country 'A' which was not originally approved..

Background and nature of export of defence items

1.15. It is seen from the Audit paragraph that in pursuance of the decision taken by the Ministry of Defence, a special cell was set up in the Department of Defence Production in February 1973, to handle

export order for some specific items of equipment and stores on a commercial basis, for the sake of utilising spare capacity in the ordnance factories and to earn foreign exchange.

1.16. During evidence, the Secretary (Defence Production) informed the Committee that export was not the basic objective of production of defence stores in Ordnance Factories. Elaborating the point, he stated:

“At the moment, our ordnance factories are not a commercial organisation; they are engaged predominantly in producing for our armed forces. This is slightly different from some of our defence Public Sector Undertakings, which are not only commercial organisations, but also deal with a production mix, some of which is for export. For instance, we have Bharat Electronics which produces a lot of electronic equipment, non-lethal in character, purely for civil use or for the use of professional departments like Telephones, P&T, Radio etc. as also Shipyards. Corporations like the Bharat Earth Movers do make equipment for export and go about seeking export of that equipment. In the case of ordnance factories, export is an objective, but still not a basic objective. We have in our actual experience of running defence industries come to the conclusion that some degree of export is unavoidable and even desirable for the reason that in the very nature of defence demands, they are not such as some in steady doses; they do tend to fluctuate. The fluctuations have a lot to do with the changing requirements of the Armed Forces. The changes relate in turn to training, the extent of war wastage reserve, the need to replenish those reserves, and the shelf life of various kinds of ammunition.

So, in the nature of these demands that are projected on the DGOF, defence requirements have a tendency to fluctuate and fluctuate very widely. I have some facts, and figures and to give an example of the kind of fluctuations that occur, and roughly this happens, suppose we need 20,000 Nos. a year for 2 or 3 years running and then suddenly in the fifth year . . . the demand drops to 2000 to 3000 because you have built up the stocks necessary for what we call the war wastage reserves and, thereafter, the demand drops to what is called the training reserve.”

The witness further added:

“Then the problem arises: what do you do to tackle this problem of fluctuating demands. . . . We found the answer is not that when this drop in demand comes, you shut down your shop, through away your jigs, tools and instruments, discard your equipment and retrench your men, not only because of the hardship it involves to the labour that we employ but also because you want in the interests of defence itself to keep alive your skills, to keep your shop open, to keep your capacity to produce for defence, if and when overnight or at a short notice demands should be imposed upon you which are directly related to defence. So, in this background we found that for certain items like the ones we are discussing, we have run into a situation or stage where the demands have dropped and we have to go in for what we call diversification. Slowly we came to the conclusion that there are broadly two areas in which we can diversity.”

1.17. Explaining the two feasible areas of diversification of items of defence production, the Secretary (Defence Production) stated:

“One is the area of picking up export orders where this may be desirable and possible and discreet to carry out and another is diversification of the same capacity and skills and equipment to produce goods for civilian needs so as to improve the economic viability of our projects and so as to keep our skills alive and keep your managerial and administrative skill alive and to keep our skilled and unskilled labour in position so that they could be commandeered to produce requirements of defence whenever that demand picks up again.”

1.18. Explaining the selective and discreet basis on which the export of defence items should be undertaken, the witness confirmed:

“ . . . we have been, for some years engaged in exports on a limited scale, on a highly selective basis, as discreetly as we can and on a low profile and taking as much care as we can, not to get involved and entangled in any areas of conflict or supply to countries which might prove embarrassing to us and which is the reason why we ask for end-user certificates.’ ”

1.19. On an enquiry about the agencies consulted at the time of selection of party to whom hardware were to be exported, the witness stated:

“Primarily we go by the advice of the Ministry of External Affairs..

The decision to select the country is a matter which depends on the enquiries which come in our way because of our policy of doing it on a low profile and not treating this as a commercial operation but from the angle of discreet necessity. We do not go round the world seeking this business and establishing contracts and setting up arrangements for export. We handle such enquiries as come in our way. When those enquiries come, what we seek is to know the end use to which the intending purchaser wants to put the equipment. Then we consult the Army Headquarters from our security, or defence point of view. We consult the Ministry of External Affairs from foreign relations point of view and then take a judgement.”

1.20. The witness confirmed the presumption of the Committee that so much concern was not about the sale of the goods but what was of more concern was that defence stores did not get into the hands which were not approved.

1.21. On enquiry the Committee were informed that export of military hardware was started a little before 1972.

Deviations from the prescribed policy/decision for export

1.22. According to the Audit Paragraph, while no formal procedures were laid down for dealing with transactions for export of defence hardware, it was decided in September 1973, in a high level meeting in the Ministry of Defence that while agents could be appointed to explore the market, the final deals would be on a Government-to-Government basis and stores in all cases despatched direct to the Government concerned.

1.23. On an enquiry about the need for this decision of Government-to-Government basis transactions, the witness informed:

“At that point of time that was the thinking of the government.”

1.24. Elaborating, the Secretary (Defence Production) explained that in the 1973 meeting, the point was made that there might be no objection to deal with agents of foreign governments if they were reputable. That meeting was held at Inter-Ministerial level. There were representatives of Ministry of Defence as well as Economic Affairs, External Affairs, Finance (Defence) and so on. The same meeting in which the policy of Government to Government transaction was commended had also authorised dealings with agents of foreign government if they were reputable.

1.25. The representative of the Department of Defence Production further clarified:

‘The fact is that in this particular transaction the decision not to deal directly with the concerned Government was allowed by the then Government.’

1.26. The Committee enquired about the authority which approved this particular deal and also whether this was a blanket approval or specific for this case only. The Committee further desired to know the date on which this approval was given together with the reasons for regularisation of the deviation|violation and the circumstances under which it was mooted. In a note the Department of Defence Production stated as follows:

“...it will be clear from the minutes of the meeting held on 6-9-1973 the Government was not precluded from dealing with agents. In this particular case, the deal was approved by the then RUM on 28-8-1975 and applied only to this case...it may be stated that in view of what has been stated above, the question of regularisation did not arise.”

1.27. According to the Audit paragraph, on an enquiry received in June 1975 from an Indian firm for export of certain items, further negotiations were conducted abroad in July 1975 by the representative of the Defence Ministry with an Agent purporting to represent a foreign Government ‘A’. During these negotiations the unit price, which was earlier quoted at Rs. 900 f.o.b. (reduced to Rs. 855) to an Indian agent, was reduced initially to Rs. 775 if the order was for 50,000 units and Rs. 700 if the order was for 1,00,000 units and later to Rs. 710, irrespective of the size of the order, without the consultation of the Ministry of Finance (Defence).

1.28. On the basis of an end-user certificate produced by the Agent, agreement was also reached on the ultimate buyer-foreign Government ‘B’ subject to scrutiny, acceptance and confirmation from India. It was also agreed during these negotiations that the shipping documents would be sent direct to the foreign Government, but not the priced invoices and the transaction would be with the Agent who would in turn quote its own price to the foreign Government.

1.29. The Committee sought clarification as to whether the terms of the deal negotiated with the Agent regarding the Agent being permitted to quote its own price to the ultimate buyer were not very unusual and also whether these terms were specifically brought to the notice of the Secretary (Defence Production)/Ministry of Finance (Defence) on conclusion of the

negotiations. In a note the Department of Defence Production have stated as follows:

“In International Arms trade it is not an unusual practice for both buyer and seller pursuing a deal through a third party, i.e. agents, wherein the seller quotes a price to the agent, who in turn quotes the price to the buyer in the process earning an element of profit for himself. It was agreed in this case that no agency commission would be payable by Government of India. Hence the Agent could quote this own price to ultimate buyer. The terms of this particular sale were discussed by the then OSD with Secretary (DP) and RUM who were fully kept in the picture. It appears, however, that this particular aspect of the sale was not specifically brought to the notice of Finance (Defence).”

1.30. It may, however, be in this connection pointed out that according to the decision taken at the high level meeting in September 1973, agents' commission upto 5 per cent of the f.o.b. price could be paid without the concurrence of the Ministry of Finance (Economic Affairs Department); commission beyond 5 per cent would require specific approval of the Ministry of Finance.

1.31. In pursuance of the negotiations finalised abroad with the Agent, without consultation of Ministry of Finance (Defence) and Government 'A', not being acceptable, the Agent produced another end-user certificate from Government 'B'. On scrutiny, the 'end-user certificate' on behalf of Government 'B' was rejected and the firm asked to submit a proper certificate together with the formal order for the stores. Formal order was received from the Agent on 21 July 1975 for 35,000 units of stores (later increased to 50,000 units in August 1975) without the requisite 'end-user certificate' and even without any indication of the ultimate buyer, which *inter alia* stipulated that—

- (i) all payments would be made in Indian rupees acquired through a convertible currency;
- (ii) shipping would be arranged by the Agent;
- (iii) the requisite 'end-user certificate' would be submitted by the Agent while opening the letter of credit.

1.32. The Committee desired to know the reasons for accepting the supply order from the agent when the ultimate buyer was not known and the order was also not accompanied by a valid 'end-user certificate'. In

a note,* the Department of Defence Production intimated that the supply order based on the already negotiated price was accepted with the stipulation that the end user certificate should be produced by the Agent, which should be accepted to the Government of India. Further, according to the Agent producing an acceptable end user certificate, along with opening the Letter of Credit, the production of the end-user certificate itself was not a pre-condition for signing the supply order.

1.33. The Audit paragraph further points out that on 23 August 1975, an end-user certificate was received from the firm emanating from yet another foreign Government 'C' which did not figure in the earlier negotiations.

1.34. Subsequently, on 27 August 1975, a letter of Credit for Rs. 2.49 crores (in Indian rupees) was established by the Agent's bankers with an Indian Bank and the stores (35,000 units along with accessories) were despatched in September 1975 in a vessel chartered by the firm.

1.35. About the negotiations pertaining to the case in question entirely with an agent, the Secretary, Defence Production stated:

“...in this particular transaction it was negotiated with the private party. It was done on the basis of a document which said that it was required for the exclusive use of the Armed Forces of that particular country.”

1.36. Pointing out their concern for the mode of finalisation of the transaction with an agent on the production of an end-user certificate by him, the Committee enquired if that was the method for conclusion of transactions between Government and Government. The Secretary (Defence Production) explained:

“Even the 1973 decision did not bar any dealings with any private party as such. The crucial test is for which country it was meant and whether it was appropriate from our point of view. In this case, it was the country 'C'. Even though it was a private party to whom the sale was made, the understanding presupposed that it was required not by that party but by the Government of that country 'C'.”

The witness further explained:

“The actual experience is that enquiries came mostly on behalf of the intermediaries and that the governments concerned evidently preferred not to make direct government to government

*Not vetted by Audit.

enquiries. Presumably they also would like to be left out of the embarrassment of direct enquiries.”

1.37. The point made out by the Secretary, Defence Production during evidence that “even the 1973 decision did not bar any dealings with any private party as such” was based on the record of discussions at the high level meeting held in September 1973. It is, however, observed that the necessary decision related to the selection of foreign Agents, if they were reputable for purposes of initiating negotiations and not for purposes of finalisation of the deal with them.

1.38. On the Committee’s asking whether any formal directive in pursuance of the decisions taken in September 1973 was issued, the Department of Defence Production informed that no formal directive in pursuance of the decisions taken in the meeting in the room of former Raksha Utpadan Mantri was issued. It was not felt necessary to issue any formal directive as only broad guiding principles were discussed to be kept in view in finalising transactions of export of Defence Stores.

1.39. The Committee desired to know whether any guidelines had been laid down by Government for the selection/appointment of agents for the export deals. The Department of Defence Production appraised the Committee that no guidelines had been laid down by Government for the selection/appointment of agents for export deals but inquiries from agents were considered on merits of each case as and when received.

1.40. The Committee further enquired about the procedure followed for verifying the credentials of the agents before conducting any negotiations with them and whether such a procedure was followed in the present case. The Department of Defence Production informed the Committee in a note that although there was no laid down procedure for verifying the credentials of the agents, in cases where it was considered necessary, inquiries were made from this country’s Embassies abroad and in some cases from banks.

1.41. The Committee pointed out that when an agent said that he wanted certain goods for certain Government and he produced the requisite end-user certificate, the name of the ultimate buyer was obvious. At that stage, according to the decision of 1973, verifications from ultimate buyer was necessary. The Secretary (Defence Production) explained:

“In this case he was to us a contracting party, purchasing the equipment for use in a country ‘C’ on the strength of a document which purported to give us a satisfaction or an assurance

that it was needed for country 'C', that it would not be exported out of that country 'C' and that it is intended to meet the requirements of the Government of the country 'C'."

1.42. The Committee pointed out that the role of the Agent was to bring the seller country and the buyer country together. After the price quoted by the seller country was accepted, Government-to-Government dealings for actual sale transaction should begin. In this context, the Committee sought justification for, the fact that in this case the Agent proved to be the actual purchaser. The Secretary, Defence Production explained:

"In actual practice, we make sure about the country to which it goes. It is not necessarily our practice to seek out and deal with the Government direct."

1.43. The Secretary (Defence Production) further explained that even for actual sale, it was not their practice to insist on the transaction being necessarily direct with the foreign Government.

1.44. It was observed that in this case the agent not only explored the markets and finalised the deal but also arranged the ship and diverted the goods to some other country. According to instructions issued by the Ministry, although the stores had been issued to foreign Government 'C', the bill of lading was to indicate the Agent's bank as the consignee. The Committee, therefore, enquired whether the practice followed was not a deviation from the decision taken in September 1973. The Secretary (Defence Production) confirmed that this was true in this particular case but that was approved by the Government at that time. The witness also confirmed that excepting this end-user certificate from Government 'C' (which ultimately turned out to be a spurious document), there was no dealing with Government 'C' and Indian Government's diplomatic machinery in Country 'C'.

1.45. According to the Audit Paragraph, it was agreed during negotiations with the Agent that the shipping documents (except the priced invoices) would be sent direct to the foreign government. The original shipping documents were, however, handed over to the Agent. The Committee enquired the reasons for handing over the same to the Agent. The Department of Defence Production intimated that the available documents did not indicate as to why instructions were issued that shipping documents would be handed over to the representative of the firm.

1.46. The Committee asked the reasons for not stating the name of the country as consignee in the bill of lading instead of foreign firm's bank. The Department of Defence Production explained as follows:

“In the Bill of Lading the following words were incorporated; shipped at Bombay Embarkation Headquarters)...in apparent good vessel called M/s. Septimus for carriage to PP* NV Slavenburg's Bank Coolsingel-63 Rotterdam Ministry of Defence, Government of.*).

It would be seen from the above that besides the foreign bank the name of the country and the port of disembarkation 'PP' was also mentioned. The name of the Bank was put on the Bill of Lading as they had opened the Letter of Credit.”

1.47. The Committee further enquired as to whom and when the original negotiated copy of the Bill of Lading etc. was handed over. The Department of Defence Production intimated that it was not clear from the documents available as to whom and when the original negotiated copy of the bill of lading etc. was handed over.

1.48. According to the Audit paragraph, no steps appear to have been taken to ensure that the stores reached the intended destination as even the copies of shipping documents were not despatched to the specified foreign government until 4 weeks after the despatch of stores. The Committee desired to know the reasons for not sending copies of the shipping documents to the foreign Government concerned immediately on despatching the stores. The Department of Defence Production intimated that the delay occurred due to the fact that in the meantime this matter became a subject of investigation by Government 'C' and as such a copy of the shipping documents could be sent only afterwards.

1.49. The Audit paragraph reveals that in October 1975, the Military Adviser to an Indian Mission abroad reported that the shipment purporting to have been despatched to Country 'C' was intended for and despatched to another destination. The Committee, therefore, desired to know whether any investigation had been conducted in regard to the diversion of the stores to another destination and if so, the outcome of this investigation. The Department of Defence Production have replied:

“The matter was discussed at a high level between representatives of country 'C' and India and certain investigations were initiated but further outcome was not known to this Ministry.”

1.50. It is further seen from the Audit paragraph that in May 1976, the Agent claimed the right and option to re-sell as the buyer of the stores.

*Port named is located in country 'C'.

**donates country 'C'.

The Committee sought clarification to the effect whether the firm's aforesaid contention was not against the terms and conditions of the supply order particularly in the light of an 'end-user certificate'. In a note the Department of Defence Production intimated as follows:

"The firm's contention that it has the right to resell the stores to any other customer is not in conformity with the terms and conditions of the supply order which clearly states that the country who gives the End-User Certificate would have no right to resell or loan these items to any other country without specific approval of the Government of India. This contention of the firm was further refuted *vide* our letter dated 18-5-76 (not enclosed.)"

Verification of end user's Certificate

1.51. According to the Audit Paragraph, before the transaction, in question, was finalised, there was an enquiry by the Agent for country 'A' which was rejected and subsequently for country 'B', for which the end user certificate was produced.

1.52. Elucidating this matter during evidence, the Secretary (Defence Production) explained:—

"In the case of country 'A', we had a political hesitation. We did not accept it; in the case of country 'B', we did not have it; but we did not accept the certificate because the certificate came from a level lower than acceptable. . . . Otherwise, there was no objection."

1.53. The Committee desired to know as to how and at what stages the countries 'A', 'B' and 'C' came in the picture. The Committee also sought confirmation to the effect whether the Agent had initially indicated its intention of sending the Defence Stores for any country other than 'A' and the circumstances under which it was changed later on. In a note, the Department of Defence Production have stated:

"It appears that initially the firm wanted to know whether we could supply the stores for country 'A'. This was when OSD was abroad in the beginning of July, 1975. When it was made clear to the firm by OSD that supplies could not be made to country 'A' the firm wanted to know whether supplies could be made to country 'B' and also furnished an end-user certificate signed by an officer in the High Commission of country 'B'. During negotiations, the firm was informed that the end user certificate required further scrutiny in India and confirmation whether it was acceptable would have to be furnished

on OSD's return to India. The position regarding end user certificate was checked up with Ministry of External Affairs who were of the view that the end user certificate should be issued by the Government concerned instead of the High Commission abroad. During discussions held in Delhi on 28th July, 1975, the position was made clear to the buyer that the end user certificate signed by a junior officer in the High Commission of country 'B' was not acceptable.

"Thereafter, the firm submitted an end user certificate from country 'C' through our High Commission abroad. The end user certificate was signed by the Permanent Secretary, Ministry of Foreign Affairs of country 'C'. This was received through our Military Adviser *vide* his letter dated 10th August, 1975."

1.54. The Committee desired to know as to when the decision for rejecting the end-user certificate from country 'B' was taken. The Joint Secretary, Ministry of Defence explained:

"The contract was signed in July, 1975. But that contract only specified the conditions, the price and all that. But it was subject to end user certificate being acceptable. With this contract on hand, the purchaser, that is, the agent was trying to produce one after another a series of end-user certificates. The first was not accepted, because the country was not acceptable. The second was not accepted because the signatory was only a Junior Officer of that country's High Commission, and that was done after returning to India and showing it to the External Affairs Ministry. Because they would not agree, that was rejected. The third end-user certificate came later."

1.55. On an enquiry about the authority and genuineness of the end-user's certificate which later on turned out to be spurious, the Secretary (Defence Production) explained:—

"In this case there is an advice from our Military Adviser that in the other country this particular gentleman who has given the certificate was erstwhile Ambassador and he says that presumably it is genuine and after that he has not sent any further advice to the contrary to this date. Another bit of information is that at this end the members of the visiting Delegation of country C who said they did not know whether or not the

equipment was needed by their country, did not raise any question about the authenticity of the signature. Even in the ultimate disposal of this case, we are not in a position to say till this day whether the document is spurious or otherwise. The Government subsequently said that this commodity was not needed by them."

1.56. It transpired during evidence that the Military Adviser to one of our High Commissioners in a foreign country also indicated that although he checked from his sources that the person who signed the end-user certificate on behalf of country 'C' was identifiable, he was trying to confirm whether the signature on the certificate were of the same person. Quoting certain statements of the representative of the Agent, however, the Military Adviser had expressed certain doubts.

1.57. The Committee sought confirmation of the fact that a trade delegation of the Government 'C' visiting this country at that time had, when sounded, stated that to their information, there was no such need for their country. The Secretary (Defence Production) explained:—

"What the delegation told us that they were not aware of such a transaction or such a need on the part of their country. May I add that we had really no means of knowing whether the document was forged or spurious or not. As it happened, the subsequent developments indicated that it was not a correct one and that the Government of that country 'C' was not interested in these goods."

1.58. When the Committee asked as to why the authenticity of the end-user certificate purportedly emanating from country 'C', was not got verified from this country's Ambassador in country 'C', the Secretary (Defence Production) explained:—

"I think that would have been very desirable. But at that point of time when the contract was concluded, there was no reason to doubt the authenticity. The records seem to indicate that at that point of time there was no doubt."

The witness added:—

"It is clear in this particular instance that it is not a transaction between the Government of Country 'C' and the Government of India. That is entirely correct. What we are trying to explain is that the transaction, nevertheless, with this particular firm

was for the exclusive use of the armed forces of the Government of Country 'C' and in support of the assurance or undertaking, a document was furnished by the party purported to have been written by the Permanent Secretary of that particular country certifying that it was intended for the exclusive use of the armed forces of that country and on that basis of the then Government seems to have acted."

1.59. The Committee desired to know the steps taken or proposed to be taken by Government to ensure the genuineness of the end-user certificates. The Department of Defence Production have stated in a note that after this episode the end-user certificates issued by any country to an Agent were verified through this country's own diplomatic missions. The note further states—

"It is only after confirmation is received from our Embassies/High Commissions and the country is cleared by the Ministry of External Affairs that the stores are actually despatched."

Loss due to wrong fixation of sale price

1.60. According to the Audit Paragraph, the manufacture of the basic equipment alone (for replenishment of stocks) would, on the basis of the estimated cost of manufacture for 1976-77, involved an additional expenditure of Rs. 41.66 lakhs. Besides, accessories of the value (at cost) of Rs. 8.90 lakhs had been supplied though these were not taken into account in the cost data on which the price was deemed to have been based.

1.61. The Committee were informed by the representative of the Ministry of Defence that the hardware were loaded on the ships between 12th and 14th September, 1975.

1.62. On an enquiry about the source which furnished the cost of production, the representative of the Ministry of Defence explained:—

"The cost figure of Rs. 710 which was quoted was based on certain figures which were made available in April, 1975. At that time, the cost figures which were available with the officer who was dealing with this thing were: maximum Rs. 624 and minimum Rs. 397. The cost figure was vetted by the local audit officer of the factory. A little before this transaction took place, on 3rd June, 1975, these prices were confirmed. This officer left for London in the beginning of July. So, he had the latest figures available with him at that time."

1.63. The detailed procedure prescribed by the Ministry of Defence on 31st July, 1975, enjoined *inter alia* that the Ministry of Finance (Defence) would be consulted in regard to the contractual provisions for prices, terms of payment, deliveries etc. The prices were to be determined with reference to the current estimated cost of production with specific additional provisions for material and labour escalation, element of profit etc.

1.64. The concurrence of the Ministry of Finance (Defence) was in this case sought/obtained, *ex-post-facto* on 16th/28th August, 1975 to a unit price of Rs. 710 f.o.b. on the basis of cost data of the basic equipment (without accessories). It was stated that supplies would be delivered ex-stock and the stocks would be replenished through subsequent manufacture.

1.65. Asked about the reasons for taking more than two years after the meeting of September, 1973 in laying down the detailed procedure in July, 1975, the Department of Defence Production stated that it would not be correct to say that there was a delay of two years in laying down procedure in July, 1975 as the meeting of September, 1973 was only to discuss broad policy guidelines. Further, the order of July, 1975 which was mainly procedural in nature was not a specific follow up of the meeting of September, 1973.

1.66. The Committee desired to know as to how the Ministry of Finance (Defence) had accorded in August, 1975 *ex-post-facto* concurrence to the rate of Rs. 710 per unit (which was based on the cost data of the basic equipment—without accessories—for the year 1973-74 and for which no detailed break-up was available) without taking into account the latest estimated cost of production, escalation in labour and material cost. etc. In a note the Department of Defence Production have stated:

“When the case was referred to Ministry of Finance (Defence) it was evident that Rs. 710 was the best price that could be obtained after negotiations. This price was also more than the maximum cost of Rs. 624 each stated to have been given by DGOF on 3rd June, 1975. The estimate of Rs. 624 evidently took into account escalation as 73-74 cost was stated to be Rs. 442.70. In view of this, the Ministry of Finance (Defence) agreed. Note was also taken of the point made by OSD, Department of Defence Production that without further additional orders the production line for these items in the factory concerned faced closure. Such a closure would have meant loss by way of idle time payments and non-utilisation of installed capacity.

As for accessories, it was mentioned in the note that the item will be supplied along with one magazine. In the absence of any indication to the contrary, it was assumed that the cost data indulged the cost of this item. However, subsequent investigations revealed that the estimated maximum cost then indicated was only for the weapon and did not include the cost of one magazine or the other accessories, which although are not mentioned in the note put up to the Ministry of Finance (Defence), were actually supplied."

1.67. The Committee desired to know the general approach with regard to executing supplies ascertaining, in particular, whether the supplies were effected from the extra and additional production or from ex-stock, to be replenished later on. The Secretary (Defence Production) explained:—

"As a general rule, we would like to export what is surplus for our own production. We will welcome an export which involves additional order to our Ordnance Factories where we have the additional capacity, not to draw them from the stocks of the Army and sell them and wait for the future to replenish the stocks of the Army. This is the position."

1.68. When the Committee pointed out that it appeared from above that what was sold out was out of additional production, the Secretary (Defence Production) explained:—

"We do both, if I may say so, in actual fact. Keeping in view the export enquiry, keeping in view the production of particular factories, keeping in view at what level the Army has been able to build up its "War Wastage" reserve as we call it, and other reserves, and depending upon the factors arising at any point of time, we actually do the other thing also, namely, to take export, order on the basis of supply from stocks on the understanding that, to the extent necessary, the replenishment will come from new production in our own factories. It does happen in other cases. But in no case is it an export order at the cost of something which is needed by the Army. This is the position."

1.69. Explaining at the instance of the Committee, the position about the loss sustained due to wrong fixation of price and non-accountal of

charges for accessories, transport, packing etc., the Secretary (Defence Production) stated:—

“I would like to start with the accessories, transport and packing charges. I think, it would be entirely appropriate to say at the very outset that, as it would appear from the record, there was an omission in not taking specific note of the elements of accessories. I would explain the full background about the price that was actually negotiated. They started with a price of Rs. 900. Then, at a particular stage, a discount of 5 per cent had to be offered as a result of the negotiations. I believe, the price that they were trying to get was Rs. 775 and, finally, as a result of the give and take that usually takes place in such negotiations, they were ultimately able to sell for Rs. 710.”

1.70. The Committee enquired as to why prior clearance from Finance about the rates agreed upon with the foreign firm was not specifically obtained. The Department of Defence Production explained that the OSD was aware of the fact that in June, 1975 the estimated maximum and minimum cost of the item were Rs. 624 and Rs. 397 respectively. According to the Department OSD before his departure for abroad, was also fully aware that there was no demand for this item from the Army and if no orders were placed on the DGOF there would be idle time payment. During negotiations abroad OSD could get a price of Rs. 710 only.

1.71. Advancing reasons to justify that there was virtually no loss in the deal, the Secretary (Defence Production) stated as follows during evidence:—

“I would like to submit a few more facts prevailing at that particular point of time, about the state of factory that produced this particular item. In 1971-72, the production level of this particular item was as much as 45,000. It had been coming down and by the time we came to 1975-76 to which period this transaction relates, the demand on this factory had dropped to 9,092 as against 45,000. The demand for 1976-77 was zero. We had a problem of what to do with the factory, whether or not to keep the factory going, how to keep the factory going if we do not utilise the capacity in that factory skill-wise, labour-wise and equipment-wise. I have some figures to submit to you in this regard. We worked out that if you were to take the loss of idle time for one year, it would have been an amount of Rs. 36 lakhs loss. If you add to it an element of interest on the money earned on this particular transaction, it would come to a total amount of Rs. 41

lakhs loss. The point is therefore whether you want to take Rs. 41 lakhs as 'loss'. Actually, it is not Rs. 41 lakhs but it is lower. The Audit has arrived at the loss on an estimated figure for a particular year for which we have now more precise figures which I shall presently submit to you."

1.72. Elucidating the point further, the representative of the Ministry of Defence stated:—

"Probably the loss of Rs. 41.66 lakhs which was mentioned in the Audit Report is computed on the basis of the estimated cost given which was Rs. 829 per piece. But when it was actually manufactured, we have got the figure of the cost of production. The cost of production is Rs. 706.60. Therefore, the loss has not been of the order which has been indicated in the Audit Report."

1.73. Intervening, the representative of Audit stated that the actual cost of production had been mentioned as Rs. 706, but the price to be quoted was to be determined with reference to current year's cost of production with reference to specific conditions. Seeking confirmation of the fact that this was taken into consideration, the Committee desired to know the details of Rs. 706. The Secretary (Defence Production) stated:—

"I made this point in the beginning that we have been remiss in not including accessories and the cost of packing and all that. From the record it would appear that the accounting was not done. So far as the estimated figure of cost of production is concerned, that estimate happened to be Rs. 706. So, the order of the loss is not so much; it is very much less. But as regards the accessories and other parts, when the question comes, with your permission, I would like to make a few comments. The main point is when you decide to export, you should bear in mind one thing and that is you should say that you will accept a particular price and that you will not sell below that price. In this particular case, to a large extent, the price at which this sale was effected was Rs. 710. We will have to offset against this so called loss what we would have had to incur if we did not take this export order and we had kept our factory completely idle, etc. Then there is one option not to do export and lose, let us say, Rs. 45 lakhs by keeping the factory idle or doing all that. This is the submission which I would like to make. As far as export is concerned, ultimately, in all these negotiations, we can only sell it at a price at which the international market will take it. We will

have an option indeed not to sell it. In this case, not to sell has to be considered in the background of what would happen to our factory if we do not export."

1.74. The Secretary (Defence Production) agreed when the Committee pointed out that the basic cost had got to be with reference to replenishment.

1.75. At the instance of the Committee, the Secretary (Defence Production) explained the question of potential loss as follows:—

"Roughly Rs. 24 lakhs; it has to be viewed against our estimated loss of Rs. 36 plus Rs. 8 lakhs, *i.e.* Rs. 44 lakhs if you did not take this order and kept the production idle."

1.76. Recalling the observation of the Secretary (Defence Production) that export was not the main objective of Defence Production and the main objective was to set up a vital capacity to meet the needs of the country's armed forces, the Committee pointed out that even if there was no export and there was no country coming forward to buy defence hardware, the army factories would not be affected much. How then did the consequences of closure, non-sale, non-export etc. were material the Committee enquired. The Secretary (Defence Production) stated:—

"At the time the transaction of export was undertaken and accepted by the then Government, it fitted in with the policy of advocating judicious exports to keep alive the factory and it was a permissible thing to do. Apparently, those who decided at that time did not think that this would be the embarrassment that would be caused thereby. This is a kind of risk which one has to take while running the business of export abroad and dealing with other countries."

1.77. When the Committee asked whether it could be presumed that development on the ordnance front had come to a stage where export or sale had become a vital point, the Secretary (Defence Production) explained:—

"That is not the part of their economy."

1.78. The Committee note that in February, 1973 a special cell was set up in the Ministry of Defence (Department of Defence Production) to handle export orders for some specific items of equipment and stores on commercial basis. This was done in implementation of the decision of the Ministry to promote the export of such items, with the intention of utilising spare capacity in the ordnance factories and to earn foreign exchange. At

a high level meeting held in September, 1973, broad guidelines for undertaking export of specific defence items were enunciated. The Committee were informed during evidence that defence requirements had a tendency to fluctuate and sometimes fluctuate very widely. Further, for certain items, like the one, dealt with in this Report, a stage had reached, where the demand for defence had dropped very considerably, calling for some alternative avenues of utilization of the installed capacity either by picking up export orders or by diversification of the capacity and skills to produce goods for civilian needs so as to improve the economic viability of the factories and to keep managerial and administrative skills alive so that they could be instantaneously pressed into service to produce requirements of defence, whenever that picked up again. The Committee appreciate the general approach for this important decision. However, the Committee fail to understand as to why no formal detailed directive was issued in pursuance and elaboration of the decisions taken at the high level meeting held in September, 1973, which according to the Department, themselves had enunciated only the broad guiding principles.

1.79. The Committee are further distressed to note that detailed procedure for sale of defence stores was laid down only in July, 1975. Had such detailed instructions been issued the omissions and commissions that have been referred to in the Audit Para would not have perhaps occurred. The Committee would like to know as to why the question of laying down detailed procedure was not considered essential at the initial stage itself in the light of broad guidelines enunciated in September, 1973, particularly when a special cell was in existence since February, 1973 to handle the export orders.

1.80. The Committee note that at the high level meeting held in September, 1973, in the Ministry of Defence, it was inter alia decided that while agents could be appointed to explore the market for export of stores, the final deals would be on Government-to-Government basis, and stores in all cases despatched direct to the Government concerned. The representative of the Ministry confirmed in very explicit terms during evidence that "we have been, for some years engaged in exports on a limited scale, on a highly selective basis, as discreetly as we can and on a low profile and taking as much care as we can, not to get involved and entangled in any areas of conflict or supply to countries which might prove embarrassing to us" The Committee deem it highly lamentable that in a case of execution of an order for export of 35,000 units of stores, the entire deal was struck and executed in utter disregard of the aforesaid considerations and the discreet and cautious approach enjoined upon in such matters was given to go by. That the deviation from the prescribed procedure was not entirely unintentional is borne out by the fact that the deal was not only concluded in entirety with the foreign Agent, but, graver still, no steps

were taken to ensure that the stores actually reached the intended foreign destination.

1.81. Justifying the correctness of finalizing the entire deal with the foreign Agent, the Secretary (Defence Production) pleaded during evidence that the same meeting (September, 1973) in which the policy of Government-to-Government transaction was enunciated also authorised dealings with foreign agents direct, if they were reputable. When the transaction with the Agent was really authorised under the original guidelines of September, 1972, the Committee fail to appreciate the need for obtaining special approval from the authorities concerned for this unusual step. On perusal of the relevant portion of the record of discussion at the aforesaid meeting the Committee do not find any such authorization. It speaks only of selection of foreign Agents, if they were reputable, for purposes of initiating negotiations and not for purposes of finalisation of the deal with them.

1.82. The Committee note that initially, the Agent wanted to negotiate the export deal for country 'A' but that was not followed, as the country was not acceptable. Thereafter, the Agent negotiated the deal for country 'B' on the production of an 'end user certificate' from that country, but this certificate was rejected because it was not signed at the required level. Finally, the export deal was finalised for country 'C'.

1.83. The Committee were informed during evidence that there was not so much concern about the sale of the defence stores but what was of more concern was that they did not get into unapproved hands and as a safeguard, production of an 'end-user certificate' had been prescribed. The 'end-user certificate' is a written affirmation from the foreign Government that the stores are intended for its own exclusive use and would not be sold, transferred or diverted without the sellers' permission. The Committee are surprised to see the lack of seriousness displayed in conducting verification of the genuineness and authenticity of the final 'end-user certificate' from country 'C'.

1.84. Explaining the position about the earlier rejection of the proposal for sale of stores to countries 'A' and 'B', the Secretary (Defence Production) stated during evidence that in the case of country 'A' there was 'political hesitation' but in the case of country 'B', the end user certificate was not acceptable as it was "from a level lower than acceptable". Finally, an end-user certificate was received on 23 August, 1975, from the Agent, emanating from foreign Government 'C', which did not figure in their earlier negotiations. The very fact that the Agent was successively naming countries and had previously submitted a certificate which was not found acceptable and the final one from a source which had not figured previously in the negotiations should have ordinarily cautioned the Government to verify the

bona fides of the Agent's latest proposal. Even when the Military Adviser to one of our High Commissioners had, expressed some doubts at the time of confirming whether the signature on the 'end-user certificate' was genuine or not, the matter was not followed up. Subsequently, when the trade delegation of the country 'C' visiting this country at that time, stated, "that they were not aware of such a transaction or such a need on the part of their country" the doubt should have further strengthened. Yet, the officers responsible for negotiating the deal remained completely unperturbed and did not move to investigate the credentials of the agent and the genuineness of his proposal and the authenticity of the end-user certificate furnished by him. The Committee fail to agree with the contention of the representative of the Ministry that "we had really no means of knowing whether document was forged or spurious or not". The unfortunate consequences of this deal could have perhaps been avoided had, at that stage, verification of the end-user certificate been made at least from this country's Ambassador/diplomat in country 'C'—a course now proposed to be followed after the sad experience in this case. Even the Secretary (Defence Production) himself during evidence admitted the desirability for such a verification. The Committee are amazed to learn from the Secretary (Defence Production) that the Government "are not in a position to say till this day" whether the end-user certificate produced by the Agent from Country 'C' was spurious or otherwise". The Committee are at a loss to understand as to why it has not been found possible thus far to verify the authenticity of the end-user's certificate from country 'C'. The Ministry of Defence owe an explanation to the Committee for this apathy.

1.85. It was also decided at the high level meeting in September, 1973 that "agents' commission upto 5 per cent of the f.o.b. price could be paid without the concurrence of the Ministry of Finance (Economic Affairs Department); commission beyond 5 per cent would require specific approval of the Ministry of Finance." The Committee are surprised to learn from Audit Paragraph that during the course of negotiations with the Agent, it was mutually agreed upon that the transaction would be with the agent who would in turn be free to quote its own price to the foreign government. This aspect of sale was not brought to the notice of Finance (Defence). The Committee feel that a blanket authority to the agent for quoting his own price is in complete contravention of the decision taken in September, 1973 with regard to the payment of agents' Commission. In fact, this authorization appears to be one of the reasons for promoting the agent to play a foul in this whole deal culminating in the despatch of stores to country 'A' which was not originally approved of by adopting a devious course of action.

1.86. Apart from the foregoing, the Committee have observed the following glaring lapses and omissions and Commissions in the case which

prove beyond doubt the perfunctory approach and indifference to the prescribed procedures on the part of the authorities concerned:

- (i) Though the 1973 guidelines required the stores to be despatched direct to the foreign government concerned, these were actually despatched in September 1975 on f.o.b. basis with bill of lading in favour of the agent's bankers.
- (ii) The shipping documents, which according to the negotiated terms were required to be sent to the foreign buyer, were in fact handed over to the agent. The Department has not been able to find from the existing records any explanation for this violation of the negotiated terms of agreement.
- (iii) Copies of shipping documents were sent to the foreign government for whom the defence stores were sold to the agent, 4 weeks after the despatch of stores. This delay facilitated in the diversion of stores to a country other than that for which they were intended and this country was the same to whom the sale of stores were earlier refused on political considerations.

1.87. The above distressing features of the transaction create an irresistible impression in the mind of the Committee that there might have been complicity and collusion between the officers responsible for the deal and the agent. The Committee consider that this matter requires a thorough investigation with a view to fixing responsibility for the lapses in this case and for taking necessary remedial measures for avoiding its recurrence in future.

1.88. According to the detailed procedure prescribed by the Ministry of Defence on 31 July, 1975, Ministry of Finance (Defence) were required to be consulted with regard to the contractual provisions for prices, terms of payment, delivery etc. The prices were to be determined with reference to the current estimated cost of production with specific additional provisions for material and labour escalation, element of profits etc. The concurrence of the Ministry of Finance (Defence) was in this case sought/obtained, ex-post-facto on 26/28 August, 1975 to a unit price of Rs. 710 f.o.b. on the basis of the cost data of the basic equipment (without accessories). It was stated that supplies would be delivered ex-stock and the stores would be replenished through subsequent manufacture.

1.89. The Committee are surprised to learn that according to the calculations made by Audit, Government had to suffer a huge loss of about Rs. 41.66 lakhs, being the additional expenditure involved in the manufacture of basic equipment alone (for replenishment of stocks) on the basis of estimated cost of manufacture for 1976-77. The Secretary (Defence Production), however, explained during evidence that the extent of loss was not

to the aforesaid extent as the audit's estimate of loss is based on the estimated cost of production of Rs. 829 per unit whereas the actual cost has turned out to be Rs. 706. According to him, the figure of loss of Rs. 41.66 lakhs would come down to about Rs. 24 lakhs on the basis of actual cost of production. Further, according to him, in the year 1975-76, to which the transaction related the demand on this factory had dropped to 9,092 units as against the production level of 45,000 units and the demand for 1976-77 got reduced to zero. As such, but for the order in question, there would have been a loss of Rs. 36 lakhs on account of non-utilisation of the capacity of that factory skill-wise, labour-wise and equipment-wise and if the element of interest on the money earned on this particular transaction was also added, it would have come to a total amount of Rs. 44 lakhs. According to the Secretary (Defence Production) the loss of Rs. 24 lakhs on the basis of actual cost of production for replenishment purposes would have to be viewed against the national loss of Rs. 44 lakhs if they did not have this order and consequently kept the factory idle. The plea advanced by the Secretary (Defence Production) for off-setting the actual loss of Rs. 24 lakhs by a national loss of Rs. 44 lakhs due to the possible closure of the factory for a year is not acceptable to the Committee in view of the fact that export is not the main objective of defence production and the question of closure of the ordnance factory was only hypothetical. The Committee are astonished that even the Ministry of Finance (Defence) accorded their ex-post-facto sanction to the deal disregarding the prescribed procedures for working out the cost price.

1.90. The Committee are further perturbed to learn that accessories valued at Rs. 8.90 lakhs have been supplied with the stores though these were not taken into account in the cost data on which the price was based. The Secretary (Defence Production) conceded during evidence that there was an omission in not taking specific note of the element of accessories. The Committee would like that the inquiry suggested by them in paragraph 1.87 would also cover this costly lapse resulting in a loss of Rs. 8.90 lakhs.

MODERNISATION OF PROCESSES OF PRODUCTION IN A FACTORY

Audit Paragraph

2.1. In May, 1970 a factory put up a proposal to the Director General, Ordnance Factories for replacement of the existing plants 'X' and 'Y' by modern ones. Plant 'X' was to consist of two units, each with a capacity to produce 65 tonnes of 'P' per month based on working for 24 hours a day and 22 days a month; one of the units was to be capable of switching over to 'P' for industrial use in lieu of 'P' for services' use, so that maximum utilisation of the capacity could be made during peace time. Plant 'Y' was to consist of two self-contained units, each capable of producing 90 tonnes per month of 'PQ' past, by wet mixing process. The proposal envisaged an estimated cost of Rs. 507 lakhs including Rs. 102 lakhs for civil works.

2.2. On 26th June, 1970, the Director General, Ordnance Factories placed two 'operational' indents on the Director General, Supplies and Disposals for purchase of these two plants 'X' and 'Y'. In response to the tender enquiries, three offers were received from foreign firms. On 15th November, 1971, contracts were concluded with firm 'C' for supply of both the plants 'X' and 'Y' with spare parts, licences, know-how etc. at Rs. 308.88 lakhs (later amended to Rs. 310.05 lakhs) and Rs. 139.05 lakhs (later amended to Rs. 139.27 lakhs) respectively. The warranty period available for plants 'X' and 'Y' under the contract was for a period of one year from the date of satisfactory commissioning subject to the condition that the warranty would expire at the end of 3 years from the date of the last delivery of equipment.

2.3. In 1972 on the advice of the firm which was to supply the plants, it transpired that the acid mixing system would also need modernisation.

2.4. Sanction for the project as a whole was accorded by the Government only in July 1973 as per the following particulars:

	(Rs. in lakhs)	
	Total	Foreign exchange compo- nent.
Plants 'X' and 'Y' duly erected and commissioned	811.41	568.59
Modernisation of acid mixing system	119.45	8.47

Miscellaneous, maintenance items, transport, equipment etc.	24·53	2·8
Services forming Director General, Ordnance Factories responsibility -	20·37	..
Civil works and services forming Military Engineer Services' responsibility (excluding cost of water supply from an existing reservoir)	187·20	..
Planning and security staff training	14·56	0·46
Total	1177·52	519·60

2.5. Plants 'X' and 'Y' were supplied as follows:—

Plant	Actual date of completion of supply
'X'	July 1973
'Y'	July 1974
'Y' First supply	
Second supply	February 1976

2.6. The warranty periods available for plants 'X' and 'Y' under the contract with reference to the last delivery of the equipment were to expire as follows:—

Plant 'X' (units I & II)	July 1976
Plant 'Y' (Unit I)	July 1977
Plant 'Y' (Unit II)	February 1979

2.7. To take full advantage of 12 months' warranty period after satisfactory commissioning, the Director General, Ordnance Factories gave the following programme in December, 1971 to the Military Engineer Services for completion of civil works.

Event	Plant 'X'		Plant 'Y'			
			Unit I		Unit II	
	Date	Month	Date	Month	Date	Month
Contract date	January 1972	0	January 1972	0	January 1972	0
Receipt of building data and convening of sitting board	July 1972	6	July 1972	6	August 1974	31
Approval of sitting board proceedings	September 1972	8	September 1972	8	October 1974	33

Approximate estimates .	October 1972	9	October 1972	9	February 1975	37
Administrative Approval	November 1972	10	November 1972	10	June 1975	41
Handing over of building shell for erection (6 buildings each) .	March 1974	26	March 1974	26	October 1976	57
Completion of buildings	February 1975	37	December 1974	35	July 1977	66
Commissioning of plants	August 1975	43	June 1975	41	January 1976	72

2.8. This time schedule was not agreed to by the Military Engineer Service authorities who indicated in January, 1972 that completion of shell stage of phase I (Plant 'X' and unit I of plant 'Y') and phase II (unit II of plant 'Y') works would require 25 months and 29 months respectively instead of 16 months from the date of issue of administrative approval envisaged by the Director General, Ordnance Factories. Pending a final decision in the matter, a go-ahead sanction for Rs. 45 lakhs was accorded in April, 1972 for carrying out preliminary civil works augmentation of water and electricity supply, initial procurement of steel etc. In April, 1973 sanction was issued by Government for civil works and services for plant 'X' and phase I of plant 'Y' at an estimated cost of Rs. 117.54 lakhs (amended to Rs. 123.01 lakhs in August, 1976) for completion within 140 weeks from the date of sanction (*i.e.* by December, 1975).

2.9. The civil works were, however, completed as follows against the dates of completion stipulated in the works contracts:—

Civil Works for	stipulated date of completion as per the contracts of the civil work	Actual date of completion.
Plant 'X'	September 1975	June 1976
Plant 'Y'	December, 1974	March 1975

2.10. The factory was authorised by the Ministry to conclude two contracts in August, 1974 with a firm for erection of plant 'X' and one unit of 'Y' at an estimated cost of Rs. 29.87 lakhs. The erection of plant 'X' commenced during October, 1974 and was completed by September, 1975. The erection of one unit of plant 'Y' was completed by April, 1975. After erection of plants 'X' and 'Y' (one unit), it was found that concrete blenders were leaking and this delayed commissioning trials. The Ministry intimated in December, 1976 that the concrete blenders of plants 'Y' were satisfactorily rectified by June, 1976. Of the 8 concrete blenders for

plant 'X' rectification of 7 blenders was stated to have been completed in October, 1976 (including one under test) and one was awaiting rectification.

2.11. The sanction accorded in July, 1973 (20 months after the contract was entered into) included provision for treatment and filtration of water at a cost of Rs. 14.87 lakhs (subsequently amended to Rs. 19.63 lakhs) but did not include any scheme for augmentation of water supply. It was, however, assessed in April 1974 that with the completion of the 'new projects' the requirement of water supply would increase to 60 lakh gallons per day at the peak level of production (including 8 lakh gallons for other units in that area) against the current availability of 23 lakh gallons per day of fresh water and 10 lakh gallons per day to be procured by recycling for which provision existed in the factory. To meet the additional requirements of 27 lakh gallons, sanction for desilting a lake which was a source of water supply to the factory, was sought in August, 1974 by the Director General, Ordnance Factories. While seeking Government's approval it was stressed in October, 1974 by the Ministry of Defence that if there was to be no delay in the commissioning of the plants 'X' and 'Y' within the warranty period available for these plants, the desilting operation should be completed not later than the middle of 1966. The sanction of desilting the lake was accorded at an estimated cost of Rs. 1.50 crores in July, 1975 and according to this sanction, the desilting was to be completed by 150 weeks from the date of sanction—that is by May, 1978. The Ministry, however, stated (December, 1976) that the scheme for desilting of the lake was intended to increase the storage capacity to ensure adequate water supply during the lean period for sustaining production at the present reduced level and was not in any way linked with the modernisation of the plants and would not augment water supply to the factory.

2.12. It was initially planned that the mixed acid requirement for the new plant 'X' would be met from the existing acid mixing plant in the factory. However, when the representatives of firm 'C' visited India in early 1972 and the quality of mixed acid to be supplied to their plant was discussed with them, it became evident that the existing acid mixing facilities in the factory were inadequate to meet the quantity and quality requirements specified by the plant suppliers for guaranteeing product quality. As the responsibility for supply of mixed acid to the quality required for plants to be supplied by the foreign firm was the responsibility of the purchaser, the modernisation of the existing mixed acid preparation system assumed great urgency for getting guaranteed quality product from the plants to be supplied by the firm. A contract was concluded by the Director General, Supplies and Disposals in July, 1974 with a firm for supply, erection and commissioning of the acid mixing plant at a cost of Rs. 134 lakhs. As per contract, the supply of the plant was to be completed and the plant kept ready for commissioning by October, 1975. The

administrative approval for necessary civil works was issued in August, 1974 at an estimated cost of Rs. 25.61 lakhs.

2.13. The civil works for the acid mixing plant were completed in January, 1976 and the plant was erected in May, 1976.

2.14. It is reported (March, 1977) that the pre-commissioning trials in respect of both the plants 'X' and 'Y' are still in progress. The Ministry stated (December, 1976) that there had been a setback in the desilting work due to serious failure of south-west monsoon as desilting was contingent upon some minimum flow of water into the lake.

2.15. Some of the unsatisfactory features noticed in the execution of the project that:—

- (1) The scheme was not sanctioned as a whole including civil works in 1970; only the purchase of the plants was authorised at that point of time and the sanction to the scheme as a whole was accorded in July, 1973.
- (2) A co-ordinated programme of construction of civil works was not drawn up in accordance with requirements of warranty for the plants specified in the contract.
- (3) Provision was not made for the modernisation of the acid mixing plant till 1972.
- (4) The water requirement was not assessed in time and necessary works in this regard were not sanctioned till July, 1965.

[Paragraph 11 of the Report of the Comptroller and Auditor General of India for the year 1975-76, Union Government (Defence Services)].

Replacement of plants

2.16. According to the Audit Paragraph, the proposal for replacement of plants 'X' and 'Y' envisaged an estimated cost of Rs. 507 lakhs including Rs. 102 lakhs for civil works, but subsequently, sanction for Rs. 1177.52 lakhs was accorded in July, 1973 for the project. The Committee desired to know the reasons for more than 100 per cent increase in the actual sanction over the estimated cost. In a note, the Ministry of Defence (Department of Defence Production) have stated:—

“The proposal made in 1970 pertained to replacement of old/out-lived plants 'X' and 'Y'. The replacement was planned under the financial powers vested in DGOF for normal Replacement and Renewal. Proposals for placement of indents on DGS&D were concurred in by the Finance. The proposals indicated an

estimated expenditure for budgetary purposes as Rs. 507 lakhs. This indication of likely expenditure was based on informal budgetary offers obtained from three different firms in 1967.. However, at the time of actual response to the tender enquiries, the offers received from the same firms (including the other firms) from whom budgetary estimate received was almost double. The rough indication of expenditure for civil works was also based on the same. In the case of Chemical plants, the scope of civil works depends on the ultimate selection of the plant and therefore, the expenditure on civil works depended on the design of buildings recommended by the supplier of the plants whose offer was finally accepted.

At the time tender enquiries were floated, DGOF had asked the intending bidders to quote for the quality of mixed acids required as well as equipment required for acid mixing system separately to suit the manufacture of industrial grades 'Y'. Having obtained the specifications of acid mixing system, the DGOF decided not to import the same but to dovetail the proposal with replacement of the entire mixing system required for the factory as a whole which was under examination for quite some time and hence the acid mixing plant was procured indigenously and is functioning well. It may be added that acid mixing plant is required at the factory not only for meeting the requirements of plants 'X' but also for a number of other products in the factory. Taking into account that beside the procurement of plant, other ancillary units and services like acid mixing plant water, power, steams etc. augmentation of laboratory equipment, workshop facilities were also required, DGOF had two choices before him:—

- (i) to process each item as an independent proposal under Replacement and Renewal which was within his financial authority;

OR

- (ii) to submit a consolidated proposal for sanction of the Ministry of Defence so that the entire scheme is considered as a complete inter dependent system.

DGOF opted for the second choice in order to process the entire inter-dependent requirements in a cogent manner.

Therefore, it was considered prudent to consolidate all these facilities and present them in the form of a statement of case to Government and obtain Government sanction for the 'project' as a whole in July, 1972, for speedy implementation and better

co-ordination instead of processing each case in a piecemeal basis. The Government sanction for this as a whole was issued in July, 1975.

It may thus be seen that the initial estimate was a very rough indication of cost for a part of the scheme. This estimate was made for purpose of placing the indent on DGS&D for plants 'X' and 'Y'. The final Government sanction was for a consolidated scheme based on actual contract price of the plants, fuller details of civil works, erection and commissioning costs, utilities, acid mixing facilities etc."

2.17. The paragraph reveals a number of snags in the planning and execution of a defence project for the modernisation of processes of production of a factory by the replacement of the existing plants 'X' and 'Y' by modern ones, proposal for which was put up to the Director General, Ordnance Factories in May, 1970. The scheme was not sanctioned as a whole including civil works in 1970 as only the purchase of the plants was authorised at that point of time and the sanction to the scheme as a whole was accorded much later in July, 1973.

2.18. Delay in execution of the civil works reveals that a co-ordinated programme of construction of civil works was not drawn up in accordance with the requirements of warranty for the plants specified in the contract. It is further seen from the Audit Paragraph that provision for the modernisation of the acid mixing plant was not made till 1972, and that too when the representatives of the foreign suppliers, visited India in early 1972 and on discussions with them, it was known that the existing acid mixing facilities in the factory were inadequate to meet the quantity and quality requirements specified by the plant suppliers for guaranteeing product quality. According to the Audit Paragraph even the water requirement was not assessed in time and necessary works in this regard were not sanctioned till July, 1975.

2.19. The Committee pointed out that the proposal came in May, 1970 but the Purchase Order was placed in November, 1971. The Committee, therefore, desired to know the justification for taking about 1½ years in finalisation of the proposal. The Committee also desired to know the reasons for sanctioning and executing the project in a piecemeal manner. Explaining in general the justification for planning and execution of different facets of the Project, the Secretary (Defence Production) stated:—

"The project was not a factory being built on a clean slate. The proposal was to modernise an existing factory and the problem was to go about it without interruption of production because at that time, this was the only factory that was pro-

ducing propellants. The time taken between plant 'Y' and plant 'X' might appear to be unduly long, but the problem was that one could not undertake construction of plant Y until plant X and the first unit of plant Y were constructed and production satisfactorily established, because until then it was not possible to stop production in the old factory and start demolishing it and undertaking new construction there. It is like living in one part of the house and pulling down another part for rebuilding it. The starting of construction of unit 2 of plant Y was retarded by certain problems like blenders, the slippage of time on account of which was unavoidable. The blenders, in turn, delayed the satisfactory commissioning of plant X and first unit of plant Y. Time had to be spent in remedying certain defects before work on Plant Y, unit 2 could be undertaken."

2.20. The Committee enquired whether the placement of indent on 26 June, 1970 was done after ascertaining the estimated cost of the project and obtaining clearance from Government for the expenditure. In a note, the Ministry of Defence (Department of Defence Production) explained that release of the necessary Foreign Exchange and DGOF's recommendations for accepting the particular firm's offer were approved by the Government before conclusion of the contract.

Delayed and Piece-meal sanction of the Project

2.21. Sanction for the project as a whole for Rs. 1177.52 lakhs (with a foreign exchange component of Rs. 519.60 lakhs) was accorded only in July, 1973 as per the following particulars:—

	(Rs. in Lakhs)	
	Total	Foreign exchange compo- nent.
Plant 'X' and 'Y' duly erected and commissioned.	811.41	508.59
Modernisation of acid mixing system	119.45	8.47
Miscellaneous, maintenance items, transport, equipment etc.	24.53	2.08
Services forming Director General Ordnance Factories responsibility	20.37	..
Civil works and services forming Military Engineer Services' responsibility (excluding cost of water supply from an existing reservoir)	187.20	..
Planning and security staff training	14.56	0.46
TOTAL :	1177.52	519.60

2.22. The Committee desired to know as to how the contract for procurement of the new plants was concluded in November, 1971, even before the total cost of the project was sanctioned by Government. The Director General, Ordnance Factories explained as follows:—

“If I may explain, first is the selection of the plant. With the selection of the plant, we come to know the quality and the quantity of the inputs required. The main parameters on civil works, as I told you, came after six months, depending on the input requirements. We have to see what facilities exist and what extra facilities are required. Therefore, for renewal and replacement of portion of our existing factory before the selection of the plant it is not possible to plan all the facilities which go with it. They will take a little time. But the main critical path in the project is the civil works. We have to see whether these other facilities which come in between are dovetailed with the main project and that the main project does not get delayed. The analysis shows that although piecemeal sanctions were obtained, the main critical path was not loss sight of.”

2.23. The Department of Defence Production have subsequently furnished a note at the instance of the Committee, indicating the background for conclusion of the contract for procurement of the new plants in November, 1971 even before the total cost of the project was sanctioned. The note further explains the reasons for taking one and half years to issue the sanction for civil works after finalization of the contract for procurement of the plants. The note reads as follows:

“The plants were procured under normal (Renewal and Replacement) grant. Since these are replacement plants and the DGOF is empowered to place indent, Government approval for necessary commitment, release of FE and the supplier recommended by DGOF was obtained. The Government sanction of July, 1973 was for the consolidated proposal inclusive of this and other RR schemes like Acid Mixing system, along with augmentation of services and other items of expenditure like civil works, custom, ocean freight, erection and commissioning etc. Details of these expenditures were available after the contract for main plants (for which indents were placed earlier) was concluded in Nov. '71.

By placing the indent for the main plants and concluding the contract under DGOF RR betterment powers earlier, we had actually saved considerable time in executing this scheme.

As regards Civil works, the time frame was assessed as follows:—

Contract date (effective)—1/72

Sitting Board for Civil Works—

(after receipt of CW data from the firm)—7/72

Issue of Administrative approval—12/72

Civil work data are normally made available by the plant suppliers especially for chemical plants not earlier than six months from the effective contract date. As soon as these were received Sitting Board was held in 7/72 as scheduled. A/E was received in 10/72. After suitable scrutiny and seeking some clarifications the A/A was issued in 4/73.

The MES were however, given a go-ahead sanction in 4/72 itself for Rs. 45 lakhs.”

2.24. Justifying the concept of piecemeal sanction, the Secretary (Defence Production) stated that “piecemeal sanction was inherent in the very nature of things in such projects.” He further added:

“What was sanctioned, in order not to lose time, were some preliminary works which were obviously necessary, and then the go-ahead sanction was given in April, 1972.”

2.25. Explaining the position about the go-ahead approval given in 1972, the Engineer-in-Chief stated:

“Firstly, we get administrative approval and then we go to tender. In his case, money has been given and we have gone in for preliminary works.”

Execution of Civil Works

2.26. According to the Audit Paragraph, with a view to take full advantage of 12 months' warranty period after satisfactory commissioning, the Director General, Ordnance Factories gave to the Military Engineer Services, in December, 1971, programme for completion of civil works proposing the commissioning of plant X in August, 1975. Unit I of plant Y in June, 1975 and Unit II of plant Y in January, 1978. (for preceding stages see Audit Paragraph). This time schedule was not agreed to by the Military Engineer Services authorities who indicated in January, 1972 that completion of Shell stage of Phase I (Plant 'X' and Unit I of Plant 'Y') and Phase II (Unit II of Plant 'Y') works would require 25 months and 29 months respectively instead of 16 months from the date of issue of administrative approval envisaged by the Director General, Ordnance Factories.

2.27. The Civil Works were, however, completed as follows against the dates of completion stipulated in the works contracts:—

Civil Works for	Stipulated date of completion as per the contracts of civil works	Actual date of completion
Plant 'X'	September 1975	June 1976
Plant 'Y'	December 1974	March 1975

2.28. The Committee desired to know the reasons for not consulting the MES while working out the estimated period for completion of civil works and for delay in the execution of the civil works. The Secretary (Defence Production) explained:—

“The DGOF’s organisation made what in their judgement was the best estimation of the time that would be necessary for the supporting civil works at the time of negotiating the purchase the plant. As it happened, after the contract was made and the matter was turned over to MES, the MES came to the view that the time schedule that had been assumed in the headquarters of DGOF was not capable of being realised as there were some special problems. We agree that it would have been very desirable if at the time of purchasing the plant itself we were in a position to know precisely the time required by consulting the engineers concerned. But this poses so many practical problems. The engineer is not in a position to give any estimation either of cost or of time until he has known all about the plant that is going to be delivered. The plant poses certain demands of its own regarding specifications and other details that engineers have to follow. It is also not easy for the purchaser of a plant to tell the suppliers, “I need time to go back to the engineers and find out from them the time required for civil construction. I will come back to you after a few months and finalise the contract.” That is not easy, though I should not say, it is not possible. I would hasten to add here that in the light of this particular experience, we are examining

how best we can streamline the system so that this possible disharmony as between the calendars assumed by the two parties—DGOF and MES can be avoided in future.”

2.29 Explaining the reasons for delay in selecting the plant and execution of civil works, the Director General, Ordnance Factories stated as follows:—

“We placed an indent on the DGS&D on 26.6.1970 and various quotations came. At that time we sent two officers abroad to judge which of the plants will actually produce the things which we want to make. Accordingly a contract was ultimately concluded on 15.11.1971. At that stage we prepared ourselves a schedule which is reflected in the Audit Para and with that Schedule we went to the engineers. Within two months’ time the engineers gave their reactions and against 27 months which we provided for, they provided certain time schedule. But in reality they completed the work in 30 months. If the problem of leakage of blenders had not come up, the engineers would have done the work in time. So, my contention is that DGOF’s planning was based on certain experience in other plants and in reality the engineers did come to the help with the result that the net delay would have been three months if the snag of blenders had not been there.”

The witness further added:

“When the contract was about to be concluded, at that point of time we told the plant suppliers that “within a period of six months you must give us the parameters.” The firm had to do it, but without waiting for the firm to give us the details in six months’ time, we went ahead with our preparations. The contract was signed in November, 1971. We started with the planning of civil works. The engineers did not get all the details from the firm till December 1972, but they went by the previous experience. In January, 1972 they gave a revised time schedule. Thereafter, what happened was, in July, 1972 sitting Board was held and in August, 1972 the sitting Board was approved. In April 1973 administrative approval was given and thereafter the construction started. This was all foreseen. We did not have any consultants with us. The DGOF went by past experience and the actual experience has shown that we have not gone very much wrong in our assumptions. It was all foreseen before we launched the project.”

2.30. In a note, the Department has stated that "Go-ahead sanction" for preliminary works was issued on 28th April 72. Administrative Approval for the work was issued on 23rd April 73. Asked to state the reasons for delay in the issue of Government sanction, the Department have stated that it was due to clarifications required by Finance in regard to schedule rates from the Engineers before sanction could be issued. Chronological sequence of events leading to issue of the Administrative Approval has been indicated below:—

11 to 14th July 72	|	Sitting Board for the works was held.
14 Oct 72		Approximate Estimates (AE) was submitted by the Chief Engineer. Certain observations were raised by Army Hqrs. (Engineer-in-Chief Branch) on the AE.
2nd Nov 72		General Manager, Factory 'X' indicated a few major and minor changes to be made in AE.
15 Dec 72		Incompliance to the Observations of E-in-C's Branch and the indications of GM, CFA. Chief Engineer recast the AE and submitted it.
23rd Jan 73		AE scrutinised by E-in-C Branch and sent to Ministry of Finance DFA (W).
22nd March 73		DFA (W) raised some observations which were replied by E-in-C's Branch.
23 April 73		Administrative Approval issued.

The contract for construction of civil works was entered into on 10.10.73 and the prescribed date of completion of works was 15.9.1975. It is stated that originally there was no need for request for extension of completion date. But after testing the blenders and when they were found leaking, the civil works were completed only in December, 1976.

Erection of Plants

2.31. It is seen from the Audit praagraph that the factory was authorised by the Ministry to conclude two contracts in August, 1974 with a firm for erection of Plant 'X' and one unit of Plant 'Y' at an estimate cost of Rs. 29.87 lakhs. The erection of Plant 'X' commenced during October 1974 and was completed by September 1975. The erection of unit of Plant 'Y' was completed by April, 1975. After erection of Plant 'X' and 'Y' (one Unit), it was found that concrete blenders were leaking and this delayed commissioning trials. The Ministry intimated Audit in December 1976 that the concrete blenders of Plants 'Y' were satisfactorily rectified by June 1976. Of the 8 concrete blenders for Plant 'X' rectification of 7 blenders was stated to have been completed in October, 1976 (including one under test) and one was awaiting rectification.

2.32. The Ministry of Defence had also intimated Audit in December, 1976 about the remedial steps proposed to be taken to overcome the difficulties presented by the leakage of blenders.

"It has also been decided to coat these blenders with indigenous Epoxy Paint as an additional safety measure to avoid future leaks. This would of necessity be a source of some delay but in the interest of safety is considered unavoidable."

2.33. The Committee desire to know the reasons for leakage in concrete blenders, particularly whether the leakage was due to defective specification or defective construction. The officiating Engineer-in-Chief explained the position as follows:

"The blender is a horizontal type of a half reservoir of reinforced concrete. Besides this, it is 7th meters in length, the bottom of the blender is off the floor by 3.6 meters and its diameter is 3.8 meters. Through this goes the stirrer. The capacity of the blenders in the case of Unit X which has 8 blenders is 68 cu.m. each and that of unit Y-I which has 4 blenders 80 cu.m. each. This is for the first time that horizontal blenders of re-inforced concrete have been used. This is the fact I wanted to mention."

2.34 Explaining the position about the designs and specifications of the blenders, the witness added:

"As far as designs and specifications are concerned, they are given by the plant suppliers. We are used to this sort of work. The work was done. When we were working on it, we had understood that something more viscous than water was to be stored inside the blenders. Some of the specifications which we did adhere to-I will just mention for your information are that the mix for the concrete was designed to give a compressive strength of 270 kgs. per square centimetres. This conforms to 1:1:3 which is a very good mix and we kept the water cement ratio to 0.42. From our point of view, it is technically appropriate and correct. However, when the work was completed, inside these blenders we did rendering of cement and sand mortar in there coats. The difference between concrete used in blender and the water tanks is that in the water tanks we invariably use water-proof compound upto 2 to 3 per cent of cement, whereas in blenders due to its non-compatibility with the chemicals it was not used. Instead rendering was done inside. In this particular case because of the explosive nature of the contents we had to be very careful because the slightest leakage of water would result in damage and explosion

The cost of these blenders was only around Rs. 2.70 lakhs. We commenced the work in February 1974 and we completed the work in December 1974. We did the testing in March 1975, The testing was done by keeping the water in these blenders for one week. We found that leakages had appeared and wet patches had also shown up.”

2.35. In a subsequent written note, the Ministry have stated:

“When the blenders were put on trial, leakage was noticed. This was investigated and rectified by the MES. According to the MES, it does not appear that there were any defects in the specifications adopted by them. Standard specifications in conjunction with the special specifications given by firm ‘C’ were adopted for construction. This was the first time that the blenders of this size and design were constructed for processing explosives. The design was complicated because the blenders were to be constructed with hemispherical bottom and with horizontal shaft assembly, bearing housing etc. below the level of slurry. No leakage whatsoever could be accepted because the ingress of explosives in the concrete could be grave hazard. In normal concrete construction, minor leakages at first filling are not uncommon which get sealed gradually with use. In this case, this could not be accepted. Hence, suitable rectification was undertaken.”

2.36 Explaining the steps taken to rectify the leakage in the blenders, the Engineer-in-Chief explained:

“Immediately when, we realised these defects, the factory authorities said that this was very dangerous. Then we said:

‘All right, we shall see what is the best method of rectifying.’

In many of the RCC tanks it is not uncommon that there are leakages. But they stop on their own after a period of time. For rectification we suggested that we could apply three coarse of sodium silicate inside. Anyway we were told by the factory authorities that it is not acceptable because there is incompatibility between the sodium silicate and explosives. We suggested a high polymer mix and also gunniting the internal surface. The latter was accepted and ultimately a firm from Madras completed the work. But it is a time-consuming process because for each process you have to work to see that there is no further leakage. After that we have to test it again. So, it is a time-consuming process as there were 12 blenders and we were to ensure that inside the body of the

blenders no particle of the mixgets lodged. This is important because any little particle of this very high explosive being lodged there could be a potential danger. So, we had to be very very careful in doing this. We finally completed this; and it took us a fair amount of time. It was completed in June and October 1966; and at the end of it, we had a final clearance report from the Vikram Sarabhai Space Centre. So far, we are lucky, because nothing has gone wrong. We are fairly confident that the treatment which we have given and which has prevented the leakage, will suffice.”

2.37 The Committee desired to know the total cost incurred in carrying out the rectification and painting works with specific clarification whether the epoxy coating was required to be done periodically and if so, at what intervals and cost? In a note the Department of production informed as follows:

“Total cost of rectification is approximately Rs. 2.2 lakhs.

The epoxy coating is to be done periodically for safety considerations. The interval at which it will have to be done is to be assessed based on practical knowledge after working for some time. So far, the epoxy painting has withstood for 9 months without any apparent damage.”

2.38 On an enquiry, whether these blenders were available indigenously, the Engineer-in-Chief explained:

“These RCC blenders of horizontal type were built for the first time, by us. We feel quite confident of taking up this job. We have sufficient experience of RCC work. We feel confident in this particular case.”

2.39 Elucidating further, Director-General, Ordnance Factories, stated:

“Most of these blenders are made of stainless steel. In this particular case, we have made out of RCC. They are much cheaper. In many cases, we came across certain troubles but we solved them.”

Incomplete Utilisation of Warranty Clause due to delays in the completion of the Project.

2.40 According to the Audit Paragraph, the warranty period available for plants ‘X’ and ‘Y’ under the contract was for a period of one year from the date of satisfactory commissioning, subject to the condition that the

warranty would expire at the end of 3 years from the date of the last delivery of equipment.

2.41 Plants 'X' and 'Y' were supplied as follows:

"Plant	Actual date of completion of supply
'X'	July 1973
"Y" First supply	July 1974.
Second supply	February 1976.
The warranty periods available for Plants 'X' and 'Y' under the contract with reference to the last delivery of the equipment were to expire as follows :	
Plant 'X' (Units I & II)	July 1976
Plant 'Y' (Unit I)	July 1977
Plant 'Y' (Unit II)	February, 1979."

2.42 After erection of Plants 'X' and 'Y' (one unit) it was found that concrete blenders were leaking and this delayed commissioning trials.

2.43. The Committee desired to know as to when did they become aware of the provisions of warranty. The Director General, Ordnance Factories explained:

"When we float the enquiry, at that time itself we ask for the warranty. Normally they give about 12 to 18 months warranty. We foresaw we are working in a difficult terrain, working with a part of the building knocked off to accommodate new construction and the other part of the building functioning. Therefore, we insisted that we should have 12 months warranty from the date of commissioning to make sure that the Plant functions efficiently and whatever money is spent is utilized usefully. Eventually we approached the firm to extend the warranty by another six months, which covered the final run of the plant."

2.44 Explaining the actual scope of the realisation of the warranty clause. The Secretary (Defence Production) explained:

"If you look (at) . . . the calendar that the DGOF had issued, you will find that we were almost within the warranty for the first item, well within the warranty for the second and third. I am talking of 12 months after commissioning. The assumption, on the basis of which the warranty had been initially

accepted, as it happened, were not realised for the reasons which I have explained earlier.”

2.45. Elaborating the position further, the Director General, Ordnance Factories, stated:

“...we try and negotiate for the longest possible warranty. The period of warranty can change from agreement to agreement. But very seldom it exceeds 36 months from the date of supply or 12 months from the date of commissioning. In this case, because of our special approach, we could get an extension of six months, beyond the warranty period contracted for.”

2.46. The Committee pointed out that because of the delay in the completion of civil works etc., the warranty period of 36 months expired before the expiry of 12 months from the date of commissioning and the difficulty could not be overcome by obtaining extension of warranty by six months. Clarifying the position, the Secretary (Defence Production) explained:

“.....The facts are that the commissioning of the plant took place in July, and July is the month when the 36 months ran out. So, although the 36 months had run out we were able to persuade them to extend it by 6 months.”

2.47. The Committee asked for a copy of the letter received from the firm conveying agreement to extend warranty period together with the following information:—

- (i) Dates, from and upto which the warranty period was extended.
- (ii) Dates on which the plants were commissioned.

In a note the Department of Defence Production have stated as follows:—

“Copy of the firm’s letter extending the warranty period is enclosed (Appendix I*).

Dates regarding warranty/commissioning of the plants are as follows:—

<i>Plant</i>	<i>Warranty expired on</i>	<i>Commissioned</i>	<i>Warranty extended upto</i>
Plant ‘X’	July 1976	7-7-1977	31-12-1977
Plant ‘Y’	July 1977	27-7-77	31-12-1977.”

*Not printed in the report.

Augmentation of water supply.

2.48. It is seen from Audit paragraph that the sanction accorded in July, 1973 included provision for treatment and filtration of water at a cost of Rs. 14.87 lakhs (subsequently amended to Rs. 19.63 lakhs) but did not include any scheme for augmentation of water supply. It was, however, assessed in April, 1974 that with the completion of the 'new projects' the requirement of water supply would increase to 60 lakh gallons per day at the peak level of production (including 8 lakh gallons for other units in that area) against the current availability of 23 lakh gallons per day of fresh water and 10 lakh gallons per day to be procured by recycling for which provision existed in the factory. To meet the additional requirements of 27 lakh gallons, sanction for desilting a lake, which was a source of water supply to the factory, was sought in August, 1974 by the Director General, Ordnance Factories. While seeking Government's approval, it was stressed in October, 1974 by the Ministry of Defence that if there was to be no delay in the commissioning of the plants 'X' and 'Y' within the warranty period available for these plants, the desilting operation should be completed not later than the middle of 1976. The sanction for desilting the lake was accorded at an estimated cost of Rs. 1.50 crores in July, 1975 and according to this sanction, the desilting was to be completed by 150 weeks from the date of sanction—that is by May, 1978.

2.49. The Committee asked the reasons for not assessing the requirement of water for the new plants keeping in view the requirements indicated by the suppliers initially at the time of processing the indent. The Committee also sought explanation from the Government for taking more than a year to sanction the project for desilting a lake when the need was urgent. In a note, the Department of Defence Production have explained:—

“The question of getting requirements of water at the time of placement of the indent did not arise. The requirement of services like water, steam, power, compressed air, are indicated by the plant suppliers only at the time of submission of quotations against tender enquiries. Again, fuller details of these are supplied by the firm ultimately selected after conclusion of contract. Immediately after conclusion of contract, the requirements were assessed and provision was made in the Government letter for treatment and filtration of water from one source (Mynella). For filtration/treatment facilities from other source (Kateri) separate sanction was obtained.

Desilting of Kateri Lake was necessarily independent of the decision to procure plants 'X' and 'Y'. Desilting of the lakes is an adequate insurance against dry spells encountered in Nilgiris and to ensure supply of raw water during lean periods. The silting up has occurred over a period of nearly 50 years on account of general conditions prevailing in Nilgiris resulting in soil erosion.

The chronological sequence of events leading to the issue of Administrative approval for the desilting scheme is given below:

August, 1974	DGOF case file forwarded to Associated Finance for approval.
January, 1975	Estimates cleared by DFA (Fys.). Meeting held in Secy. (DF)'s room on 30-1-1975.
March, 1975	After clearance by FA (DS) the file was submitted to Secy. (Expenditure) who desired certain information and referred the file to Ordnance Factory Cell on 6-3-1975.
April, 1975	Information required by Secy. (Expenditure) was furnished by Ordnance Factory Cell and the case referred to Ministry of Finance (Defence)/(Projects) on 3-4-1975. Case then referred to Engineer in Chief's Branch on 14 April, 1975.
May, 1975	Rates for the works scrutinised and cleared by Finance.
June, 1975	The case was further discussed in a meeting held by Secy. (DP) on 7-6-1975 and file referred to Finance on 16-6-1975.
July, 1975	Administrative approval was issued."

The Ministry of Defence informed Audit in December, 1976:—

“that the scheme for desilting of the lake was intended to increase the storage capacity to ensure adequate water supply during the lean period for sustaining production at the present reduced level and was not in any way linked with the modernisation of the Plants and would not augment water supply to the factory.”

2.50. Audit were also informed by the Ministry of Defence in December, 1976:—

“The estimated capacity of the existing pipe lines is 12 lakh gallons per day approximately. To convey the additional fil-

tered water, provision has been made for an additional pipeline of 14" diameter within the scope of the proposed scheme for augmentation of water treatment and supply capacity..."

2.51. Referring to the aforesaid correspondence of the Ministry with Audit, the Committee asked the Ministry to reconcile the aforesaid position with the assessment made in April, 1974 regarding requirements for additional quantity of water. The Committee also desired to know the details of the proposed scheme indicated to Audit in December, 1976 together with the expenditure involved therein. In a note, the Department of Defence Production have stated as follows:—

"Water is supplied to the factory from two sources. For filter/treatment of water from one source (Mynella) necessary provision was made in the Government letter issued in July, 1973. This scheme was completed in July, 1975. For augmenting filtration and treatment facilities from the other source (Kateri) and laying of pipelines to carry the additional filtered water treatment after the augmentation, a separate proposal was put up.

The scheme provides for provision of treatment and filtration for additional quantity of water and laying of additional pipelines for carrying extra quantity of filtered water to the factory. The scheme was sanctioned in September, 1977 for about Rs. 60 lakhs. It is expected to be completed by September, 1979."

2.52. The Committee desired to know whether the existing arrangements of water are sufficient for securing optimum production from the modernised plants and if not, the steps taken or proposed to be taken to meet the situation. The Committee also enquired about the approximate date by which the desilting of the lake was likely to be completed. In a note, the Department of Defence Production have explained:—

"The Unit II of Plant 'Y' is anticipated to be commissioned by May, 1980. The scheme for augmentation of filtration and treatment facilities at Kateri is expected to be completed by September, 1979. With the completion of this in September, 1979, sufficient treated water will be available not only for securing optimum production from the new plants including Unit II of Plant 'Y' which is scheduled to be commissioned from January to May, 1980 but for running all the plants of the factory at optimum capacity. The quantum of raw water

available and purification facilities were/are adequate for phase I when commissioned in July, 1977 and for running factory at about 50 to 60 per cent of full capacity.

Desilting of Kateri Lakes is likely to be completed by end of 1979. Hence the quantum of raw water and purification facilities will be adequate by the time Phase II is commissioned, for meeting the full requirements of the factory unless unforeseen/unlikely abnormal dry spells are encountered."

Modernisation of mixed acid system.

2.53. It is seen from the Audit paragraph that it was initially planned that the mixed acid requirement for the new plant 'X' would be met from the existing acid mixing plant in the factory. However, when the representatives of firm 'C' visited India in early 1972 and the quality of fixed acid to be supplied to their plant was discussed with them, it became evident that the existing acid mixing facilities in the factory were inadequate to meet the quantity and quality requirements specified by the plant suppliers for guaranteeing product quality. A contract was concluded by the Director General, Supplies and Disposals in July, 1974 with a firm for supply, erection and commissioning of the acid mixing plant at a cost of Rs. 134 lakhs.

2.54. As per contract, the supply of the Plant was to be completed and the plant kept ready for commissioning latest by October, 1975. The administrative approval for necessary civil works was issued in August, 1974 at an estimated cost of Rs. 25.61 lakhs.

2.55. The civil works for the acid mixing plant were completed in January, 1976 and the Plant was erected in May, 1976.

2.56. The Committee enquired as to why the need for modernisation of the existing acid mixing system was not examined at the time of technical scrutiny of the tender, in consultation with the suppliers, who are reported to have indicated all such requirements initially. In a note, the Department of Defence Production have stated:—

"The need for modernisation of existing acid mixing system was examined at the time of technical scrutiny of the tenders when received in August, 1971. Even with the best possible planning and technical knowledge, some unforeseen problems do arise whenever modernisation of a factory more specially a

chemical plant producing diverse set of product mix is undertaken. In this particular case, even as per original planning, provision was made in the tender enquiry itself to ask the plant suppliers the requirements that would arise in respect of acid mixing system. In response to this, after the quotations for the main plant were received and during subsequent discussion in August, 1971, it emerged that the plant would impose some stringent acid quality requirements which would call for suitable provision in the matter.

About that time, the factory was independently examining a proposal for replacing the acid mixing system which caters not merely to the plant 'X' but for the other elements of the factory as well. In the background of the requirement which came to light for the plant 'X' being obtained, it was felt that that it would be more economical as well as prudent to integrate the overall requirements of the factory on this account, and proposals were pursued thereafter accordingly."

2.57. As the inadequacy of the acid mixing facilities was known in early 1972, the Committee desired to know the reasons for delay in conclusion of the contract for supply, erection and commissioning of the plant in July, 1974. In a note, the Department of Defence Production have stated:—

"As soon as it was known that acid mixing facilities would also require modernisation, a full statement of case for the 'project' including this as well as other items of expenditure was made in July 1972 and Government sanction was issued in July 1973. Action was taken immediately thereafter for procurement of the acid mixing plant as a turnkey project. Since the contract to be concluded for acid mixing was for a turnkey offer for design, supply, erection and commissioning, it was necessary to have preliminary technical discussion/clarifications with the firm and select suitable supplier.

It will be appreciated that a period of one year for conclusion of contract from the date of Government sanction is the minimum period required for such cases. Further, the erection/commissioning of an acid mixing system were so dovetailed as to be ready by the time Plant 'X' will be ready for commissioning."

2.58. The Committee desired to know the steps taken right from the beginning to achieve complete coordination on the various facets of the

project viz. civil works, augmentation of water, modernisation of acid mixing plants etc. In a note, the Department of Production have stated:

“The various steps taken right from the beginning to achieve complete coordination on the various facets of the projects are enumerated below :

(i) *Civil works including augmentation of quality water.*

After signing of the contract in November 1971, DGOF worked out a time schedule for civil works based on their experience in similar projects with a view to get the full warranty of 12 months after commissioning and taking over of the plants. This time schedule was forwarded to E-in-C by DGOF vide letter No. 460/P/EP-1 dated 15-12-1971 addressed to the Director of Works, New Delhi for planning the civil works. When Director of Works (DP) had expressed their difficulty to adhere to the time schedule, the following steps were taken in consultation with the Engineers for completion of civil works.

- (a) A go-ahead sanction of Rs. 45 lakhs was issued in the month of April 1972 for demolition of existing buildings/site clearance etc. and for siting the new plant and other connected preliminary works.
- (b) It was decided that MES will complete the buildings in shell stage and hand over to factory for erection/installation of machinery. On completion of erection, MES will do the finishing civil works. The construction of buildings in shell stage was planned in such a way that when civil construction was in progress in one building erection of machinery would be carried out in other buildings. By resorting to this dovetailing of the works between factory and MES, it became possible to reduce the overall time required for civil works.
- (c) A close liaison was kept at site between factory management and representatives of Engineers for achieving the time schedule mutually agreed upon.
- (d) Periodical meetings were held among factory officers, Engineers/Chief Engineer, in the office of GM/CFA to review the progress of civil works/erection and to modify any schedule of works as necessary/expedite the completion.
- (e) Regarding augmentation of supply of treated water it is stated that when deficiency of 26.4 lakh gallons per day was found

it was decided to meet this deficiency by providing additional filtration capacity and facilities at Bynella source and Kateri.

- (f) After receipt of the Government sanction in July 1973, for the projects including the Acid Mixing Plant, procurement action for Acid Mixing Plant was progressed in highest priority. DGS&D placed A/T for Acid Mixing Plant in July 1974.
- (g) It was realised that if the sitting Board for the civil works for Acid Mixing Plant was to be convened after the conclusion on contract for the Plant, the acid mixing plant would not be installed/commissioned in time for making available the Mixed Acids for starting the commissioning of Plant 'X'. Therefore, the following steps were taken to expedite the civil works. A go-ahead sanction for an amount of Rs. 4.93 lakhs was accorded for site clearance, demolition of old buildings etc. Based on the specification finalised by us for Acid Mixing Plant, the required civil works data were made available to MES and sitting Board was convened and the AE/revised AE was forwarded by MES to DGOF in March 1974.

AA for the civil works was issued in August 1974, *i.e.*, within month after conclusion of contract for Acid Mixing Plant. The Civil works at site was started in January 1975 and was completed by February 1976. The erection of the plant equipments etc. started in June 1975 was progressed side by side with civil works and was completed in March 1976.

Hence it will be seen that several measures were taken for expediting the procurement and erection of Acid Mixing Plant and construction of civil works to ensure that the plant was ready prior to undertaking the commissioning trials in Plant 'X'."

2.59. The Committee enquired whether according to the Ministry there was any scope for better coordination between the concerned Departments. The Secretary, Defence Production explained :

"There could have been preliminary consultations between the two departments when the DGOF embarked upon the purchase of two plants and made his own calendar."

2.60. From the facts placed before the Committee in writing as well as during evidence, the Committee cannot help concluding that the project for Modernisation of Processes of Production in a Factory was ill-planned

and its execution was not very well coordinated resulting in delays ranging from 24 months to 30 months in commissioning of various units of the plants and exceeding practically the entire warranty period for the plants available under the agreements with the suppliers. That there was concurrent loss of production needs hardly be emphasised. Some of the notable features which the Committee would like to highlight are indicated in the following paragraphs.

2.61. To begin with, the project was estimated, in May 1970, to cost Rs. 507 lakhs. This estimate was, according to the Department of Defence Production, "only an estimated expenditure for budgetary purpose" which was based on "informal budgetary offers obtained from different firms." The fact that at the time of actual response to tender enquiries the very firms from whom the "informal budgetary offers" were obtained quoted a price which was almost double of what was indicated on initial inquiry, indicates the perfunctory manner in which the original estimates were prepared. The Committee can at this stage only regret the lack of seriousness in preparing the original estimates for the project.

2.62. Another explanation given for the variation between the initial estimate and the final sanction is that whereas the initial estimate was only for placing the indent for plants on DGS&D, the final sanction was for actual contract price of the plants, fuller details of civil works, erection and commissioning costs, utilisation and acid mixing facilities. That the final sanction should be for an amount almost double of the initial estimate is a sad reflection on project estimation.

2.63. The contract for the procurement of plants was concluded in November 1971 but the sanction for the project as a whole was accorded in July 1973. Thus, it took the Department of Defence Production nearly 18 months to collect the necessary details for according sanction. The Committee consider this as an unduly long period. They feel that if the sanction could have been issued earlier, the civil works would have started earlier and the Department would not have found itself in the none-too-happy predicament whereunder the execution of the project had to be spilled over the warranty period fixed for the plants.

2.64. According to the time schedule drawn up by the Director General, Ordnance Factories and given in December 1971 to the Military Engineering Service (MES) for completion of civil works, the building shell was to be handed over by the MES in 16 months after the issue of administrative approval. In January 1972, MES authorities indicated that they could not agree to the time-schedule and that completion of shell stage of Phase I

and Phase II works would require 25 months and 29 months respectively from the date of issue of administrative approval. The Committee regret the fact that the MES could not be associated by the DGOF while drawing up the time-schedule. The Secretary, Defence Production conceded during evidence that it would have been very desirable if at the time of purchasing the plant itself they were in a position to know precisely the time required by consulting the engineers concerned. He also informed the Committee that in the light of this particular experience his Department was examining how best to streamline the system so as to avoid in future a possible disharmony between the work-calendars assumed by the two parties, viz., DGOF and the MES. While regretting that this was not done in the present case, the Committee hope that a lesson would be learnt from this experience and the procedure in such cases would be streamlined so as to avoid a situation of the type that had developed in this case.

2.65. A period of more than two years of the delay in commissioning of these plants is attributable to the defects noticed in the 'blenders'. The work on blenders is stated to have been completed in December 1974 but during testing in March 1975, leakages were noticed which had to be rectified. The rectificatory work was completed in June and October 1976 and at the end of it a final clearance from Vikram Sarabhai Space Centre was obtained. The original cost of construction of blenders was around Rs. 2.70 lakhs. The rectificatory work cost Rs. 2.2 lakhs. The rectificatory work included coating of the blenders with 'epoxy paint'. As the coating is required to be done periodically it naturally would add to the maintenance cost of the plant. The Committee have been told that the blenders are made of RCC instead of steel and that it was for the first time that blenders of RCC were constructed and experimented with in such a big project like this. The Committee would like the Government to compare the expenditure, capital as well as maintenance, on RCC blenders with the expenditure that would have been incurred if the blenders were made of steel, to find out whether the decision to experiment with blenders made of RCC in this project of strategic importance was justified. It should also be examined whether on safety considerations it was worthwhile taking the risk of building RCC blenders instead of having those built of steel. The Committee would like to be informed about the results of the examination. The Committee understand that Vikram Sarabhai Space Centre had recommended certain safeguards while putting the blenders in use. The Committee fervently hope that these safeguards are being followed.

2.66. The Committee note that in terms of the contract with the suppliers, the warranty periods in respect of plant 'X' (units I and II) and plant 'Y' (unit I) expired in July 1976 and July 1977 respectively. As

these plants were commissioned in July 1977, the benefits of the warranty were not available. The Committee are, however, informed that as a special consideration, the suppliers have extended the warranty period upto December 1977. Because of what the Secretary, Defence Production, called "our special approach" to the suppliers, Government were able to get a warranty period of 5 months instead of the usual one year from the date of commissioning of the plant. The Committee regret that the factory was not able to enjoy the normal warranty benefit of one year after the commissioning of the plant precisely because of the delay in commissioning.

2.67. The warranty period of unit II of plant 'Y' is due to expire in February 1979. For enjoying the full benefit of one year warranty this unit should have been commissioned in February 1978. However, the unit is at present scheduled to be commissioned from January to May 1980. This means that warranty benefits in respect of this unit would not be available to the factory at all. This position is fraught with danger as in the event of any defects noticed during trial runs, commissioning and initial working of the unit, no legal remedy would be available against the suppliers. It is a sad reflection on the poor planning and listless execution of the project. The Committee would like the Department to investigate as to how this situation has come to develop with a view to fixing responsibility, and take such remedial measures as may be possible at this stage.

2.68. Another field in which lack of perspective planning is discernible is the water supply for the plants. The sanction for the project issued in July 1973 included a provision for treatment and filtration of water. The work against this sanction was completed in July 1975. Meanwhile, the requirement of water was re-assessed in April 1974 and it was found that in addition to the existing scheme, an additional supply of 27 lakh gallons was required. The sanction for the new scheme was sought in August 1974 and accorded in July 1975. The new scheme was originally scheduled to be completed by May 1978. The Committee, however, find that the new scheme (comprising of desilting of a lake) is "expected to be completed by September 1979". The Department has sought to minimise the implications of the delay in the execution of the scheme by stating that the scheme "was necessarily independent of the decision to procure plants 'X' and 'Y' " and that it was "an adequate insurance against dry spells encountered in (the area) and to ensure supply of raw water during lean periods." The Department have, however, in another note furnished to the Committee, themselves pointed out that "the quantum of raw water available and purification facilities were/are adequate for phase I when commissioned in July 1977 and for running the factory at about 50 to 60 per cent of full capacity." The Committee regret that the requirements of water were not assessed properly at the time of issue of comprehensive sanction in 1973.

They would like the Department to enquire into the reasons for the anticipated delay in the completion of the scheme for augmentation of water supply of nearly 16 months.

2.69. Now that the revised target of September 1979 has been laid down for the completion of the project, the Committee hope that all efforts would be made to complete the work by the target date. The completion of the scheme by the new target of September 1979 assumes added importance in the context of commissioning of unit II of plant 'Y' scheduled from January to May 1980 by which time the availability of water should be adequate to enable the plants being run to optimum capacity.

2.70. Modernisation of mixed acid system was another scheme forming part of the project which was not thought of at the time of projecting the proposals for modernisation of processes of production in the factory in May 1970. Consequently, 'operational' indents placed by the DGOF on the DGS&D in June 1970 did not include the acid mixing plant. The proposal for modernisation of the acid mixing plant could not be mooted earlier than 1972. The Department have sought to explain this lack of foresight by stating that "even with the best possible planning and technical knowledge some unforeseen problems do arise whenever modernisation of a factory, more especially a chemical plant producing diverse set of product mix, is undertaken." The Committee are not convinced and they regard this as a lapse on the part of the Department.

2.71. Even after the idea was mooted in 1972 it took nearly two years thereafter for the contract to be concluded by the DGS&D. The civil works for the plant were completed in January 1976 and the plant was erected in May 1976. The justification offered for the delay that "it was necessary to have preliminary technical discussions/clarifications with the firm and select suitable supplier" is not sufficiently convincing. The Committee feel that by advance planning and energetic action the time taken could have been curtailed and the acid mixing plant could have been erected earlier than May 1976. The Committee hope that the Department of Defence Production will give due deference to the snags highlighted in this report and so streamline the project planning and execution procedures as to make for a synchronised and coordinated effort leading to planning and execution of the projects according to a well laid-out programme.

NEW DELHI;
April 26, 1978.
Vaisakha 6, 1900 (S).

C. M. STEPHEN,
Chairman,
Public Accounts Committee.

APPENDIV

Conclusions/Recommendations

Sl. No.	Para No.	Ministry Department Concerned	Recommendation
1	2	3	4
1.	1.78	Ministry of Defence (Department of Defence Production)	<p>The Committee note that in February, 1973, a special cell was set up in the Ministry of Defence (Department of Defence Production) to handle export orders for some specific items of equipment and stores on commercial basis. This was done in implementation of the decision of the Ministry to promote the export of such items, with the intention of utilising spare capacity in the ordnance factories and to earn foreign exchange. At a high level meeting held in September, 1973, broad guidelines for undertaking export of specific defence items were enunciated. The Committee were informed during evidence that defence requirements had a tendency to fluctuate and sometimes fluctuate very widely. Further, for certain items, like the one, dealt with in this Report, a stage had reached, where the demand for defence had dropped very considerably, calling for some alternative avenues of utilization of the installed capacity either by picking up export orders or by diversification of the capacity and skills to produce goods for civilian needs so as to improve the economic viability of the factories and to keep managerial and administrative skills alive so that they could be instantaneously pressed into service to produce requirements of defence, whenever that picked up again. The Committee appreciate the general approach for this important decision. However, the Committee</p>

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2. 1.79 Ministry of Defence
(Department of
Defence Production)

fail to understand as to why no formal detailed directive was issued in pursuance and elaboration of the decisions taken at the high level meeting held in September, 1973, which according to the Department, themselves had enunciated only the broad guiding principles.

The Committee are further distressed to note that detailed procedure for sale of defence stores was laid down only in July, 1975. Had such detailed instructions been issued the omissions and commissions that have been referred to in the Audit Para would not have perhaps occurred. The Committee would like to know as to why the question of laying down detailed procedure was not considered essential at the initial stage itself in the light of broad guidelines enunciated in September, 1973, particularly when a special cell was in existence since February, 1973 to handle the export orders.

3. 1.80 —do—

The Committee note that at the high level meeting held in September, 1973, in the Ministry of Defence, it was *inter alia* decided that while agents could be appointed to explore the market for export of stores, the final deals would be on Government-to-Government basis, and stores in all cases despatched direct to the Government concerned. The representative of the Ministry confirmed in very explicit terms during evidence that "we have been, for some years engaged in exports on a limited scale, on a highly selective basis, as discreetly as we can and on a low profile and taking as much care as we can, not to get involved and entangled in any areas of conflict or supply to countries which might prove embarrassing to us." The

Committee deem it highly lamentable that in a case of execution of an order for export of 35,000 units of stores, the entire deal was struck and executed in utter disregard of the aforesaid considerations and the discreet and cautious approach enjoined upon in such matters was given a go by. That the deviation from the prescribed procedure was not entirely unintentional is borne out by the fact that the deal was not only concluded in entirety with the foreign Agent, but, graver still, no steps were taken to ensure that the stores actually reached the intended foreign destination.

4. I. 81 —do—

Justifying the correctness of finalizing the entire deal with the foreign Agent, the Secretary (Defence Production) pleaded during evidence that the same meeting (September, 1973) in which the policy of Government-to-Government transaction was enunciated also authorised dealings with foreign agents direct, if they were reputable. When the transaction with the Agent was really authorised under the original guidelines of September, 1973, the Committee fail to appreciate the need for obtaining special approval from the authorities concerned for this unusual step. On perusal of the relevant portion of the record of discussion at the aforesaid meeting the Committee do not find any such authorization. It speaks only of selection of foreign Agents, if they were reputable, for purposes of initiating negotiations and not for purposes of finalisation of the deal with them.

5. I. 82 —do—

The Committee note that initially, the Agent wanted to negotiate the export deal for country 'A' but that was not followed, as the country was not acceptable. Thereafter, the Agent negotiated the deal for country 'B' on the production of an 'end user certificate' from that country, but this certificate was rejected because it was not signed at the required level. Finally the export deal was finalised for country 'C'.

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6.	1.83	Ministry of Defence (Department of Defence Production)	<p>The Committee were informed during evidence that there was not so much concern about the sale of the defence stores but what was of more concern was that they did not get into unapproved hands and as a safeguard, production of an 'end-user certificate' had been prescribed. The 'end-user certificate' is a written affirmation from the foreign Government that the stores are intended for its own exclusive use and would not be sold, transferred or diverted without the seller's permission. The Committee are surprised to see the lack of seriousness displayed in conducting verification of the genuineness and authenticity of the final 'end-user certificate' from country 'C'.</p>
7.	1.84	—do—	<p>Explaining the position about the earlier rejection of the proposal for sale of stores to countries 'A' and 'B', the Secretary (Defence Production) stated during evidence that in the case of country 'A' there was 'political hesitation' but in the case of country 'B', the end user certificate was not acceptable as it was "from a level lower than acceptable". Finally, an end-user certificate was received on 23 August, 1975, from the Agent, emanating from foreign Government 'C', which did not figure in their earlier negotiations. The very fact that the Agent was successively naming countries and had previously submitted a certificate which was not found acceptable, and the final one from a source which had not figured previously in the negotiations should have ordinarily cautioned the Government to verify the <i>bona fide</i> of the Agent's latest proposal. Even when the Military Adviser to one of our High Commissioners had, expressed some doubts at the time of confirming whether the signature on the 'end-user certificate' was</p>

genuine or not, the matter was not followed up. Subsequently, when the trade delegation of the country 'C' visiting this country, at that time, stated, "that they were not aware of such a transaction or such a need on the part of their country" the doubt should have further strengthened. Yet, the officers responsible for negotiating the deal remained completely unperturbed and did not move to investigate the credentials of the agent and the genuineness of his proposal and the authenticity of the end-user certificate furnished by him. The Committee fail to agree with the contention of the representative of the Ministry that "we had really no means of knowing whether document was forged or spurious or not". The unfortunate consequences of this deal could have perhaps been avoided had, at that stage, verification of the end-user certificate been made at least this country's Ambassador/diplomat in country 'C'—a course now proposed to be followed after the sad experience in this case. Even the Secretary (Defence Production) himself during evidence admitted the desirability for such a verification. The Committee are amazed to learn from the Secretary (Defence Production) that the Government "are not in a position to say till this day" whether the end-user certificate produced by the Agent from country 'C' was "spurious or otherwise". The Committee are at a loss to understand as to why it has not been found possible thus far to verify the authenticity of the end-user's certificate from country 'C'. The Ministry of Defence owe an explanation to the Committee for this apathy.

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It was also decided at the high level meeting in September, 1973 that "agents commission upto 5 per cent of the f.o.b. price could be paid without the concurrence of the Ministry of Finance (Economic Affairs De-

partment); commission beyond 5 per cent would require specific approval of the Ministry of Finance." The Committee are surprised to learn from Audit Paragraph that during the course of negotiations with the Agent, it was mutually agreed upon that the transaction would be with the agent who would in turn be free to quote its own price to the foreign government. This aspect of sale was not brought to the notice of Finance (Defence). The Committee feel that a blanket authority to the agent for quoting his own price is in complete contravention of the decision taken in September, 1973 with regard to the payment of agents' Commission. In fact, this authorization appears to be one of the reasons for prompting the agent to play foul in this whole deal culminating in the despatch of stores to country 'A' which was not originally approved of by adopting a devious course of action.

9. 1.86 Ministry of Defence
(Department of
Defence Production)

Apart from the foregoing, the Committee have observed the following glaring lapses and omissions and commissions in the case which prove beyond doubt the perfunctory approach and indifference to the prescribed procedures on the part of the authorities concerned:—

- (i) Though the 1973 guidelines required the stores to be despatched direct to the foreign government concerned, these were actually despatched in September, 1975 on f.o.b. basis with bill of lading in favour of the agent's bankers.
- (ii) The shipping documents, which according to the negotiated terms were required to be sent to the foreign buyer, were in

fact handed over to the agent. The Department has not been able to find from the existing records any explanation for this violation of the negotiated terms of agreement.

- (iii) Copies of shipping documents were sent to the foreign government for whom the defence stores were sold to the agent, 4 weeks after the despatch of stores. This delay facilitated in the diversion of stores to a country other than that for which they were intended and this country was the same to whom the sale of stores were earlier refused on political considerations.

10. 1.87 —do— The above distressing features of the transaction create an irresistible impression in the mind of the Committee that there might have been complicity and collusion between the officers responsible for the deal and the agent. The Committee consider that this matter requires a thorough investigation with a view to fixing responsibility for the lapses in this case and for taking necessary remedial measures for avoiding its recurrence in future.

11. 1.88 —do— According to the detailed procedure prescribed by the Ministry of Defence on 31st July, 1975, Ministry of Finance were required to be consulted with regard to the contractual provisions for prices, terms of payment, delivery etc. The prices were to be determined with reference to the current estimated cost of production with specific additional provisions for material and labour escalation, element of profits etc. The concurrence of the Ministry of Finance (Defence) was in this case sought/obtained, *ex-post-facto* on 26/28

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August, 1975 to a unit price of Rs. 710 f.o.b. on the basis of the cost data of the basic equipment (without accessories). It was stated that supplies would be delivered ex-stock and the stores would be replenished through subsequent manufacture.

12. 1.89 Ministry of Defence
(Department of
Defence Production)

The Committee are surprised to learn that according to the calculations made by Audit, Government had to suffer a huge loss of about Rs. 41.66 lakhs, being the additional expenditure involved in the manufacture of basic equipment alone (for replenishment of stocks) on the basis of estimated cost of manufacture for 1976-77. The Secretary (Defence Production), however, explained during evidence that the extent of loss was not to the aforesaid extent as the audit's estimate of loss is based on the estimated cost of production of Rs. 829 per unit whereas the actual cost has turned out to be Rs. 706. According to him, the figure of loss of Rs. 41.66 lakhs would come down to about Rs. 24 lakhs on the basis of actual cost of production. Further, according to him, in the year 1975-76, to which the transaction related the demand on this factory had dropped to 9,092 units as against the production level of 45,000 units and the demand for 1976-77 got reduced to zero. As such, but for the order in question, there would have been a loss of Rs. 36 lakhs on account of non-utilisation of the capacity of that factory skill-wise, labour-wise and equipment-wise and if the element of interest on the money earned on this particular transaction was also added, it would have come to a total amount of Rs. 44 lakhs.

According to the Secretary (Defence Production) the loss of Rs. 24 lakhs on the basis of actual cost of production for replenishment purposes would have to be viewed against the notional loss of Rs. 44 lakhs if they did not have this order and consequently kept the factory idle. The plea advanced by the Secretary (Defence Production) for off-setting the actual loss of Rs. 24 lakhs by a notional loss of Rs. 44 lakhs due to the possible closure of the factory for a year is not acceptable to the Committee in view of the fact that export is not the main objective of defence production and the question of closure of the ordnance factory was only hypothetical. The Committee are astonished that even the Ministry of Finance (Defence) accorded their *ex-post-facto* sanction to the deal disregarding the prescribed procedures for working out the cost price.

13. 1.90 -do-

The Committee are further perturbed to learn that accessories valued at Rs. 8.90 lakhs have been supplied with the stores though these were not taken into account in the cost data on which the price was based. The Secretary (Defence Production) conceded during evidence that there was an omission in not taking specific note of the element of accessories. The Committee would like that the inquiry suggested by them in paragraph 1.87 would also cover this costly lapse resulting in a loss of Rs. 8.90 lakhs.

14. 2.60 -do-

From the facts placed before the Committee in writing as well as during evidence, the Committee cannot help concluding that the project for Modernisation of Processes of Production in a Factory was ill-planned and its execution was not very well coordinated resulting in delays ranging from 24 months to 30 months in commissioning of various units of the plants and exceeding practically the entire warranty period for the plants available under the agreements with the suppliers. That there was concurrent loss of

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production needs hardly be emphasised. Some of the notable features which the Committee would like to highlight are indicated in the following paragraphs.

15. 2.61 Ministry of Defence
 (Deptt. of Defence
 Production)

To begin with, the project was estimated, in May, 1970, to cost Rs. 507 lakhs. This estimate was, according to the Department of Defence Production, "only an estimated expenditure for budgetary purpose" which was based on "informal budgetary offers obtained from 3 different firms". The fact that at the time of actual response to tender enquiries the very firms from whom the "informal budgetary offers" were obtained quoted a price which almost double of what was indicated on initial inquiry, indicates the perfunctory manner in which the original estimates were prepared. The Committee can at this stage only regret the lack of seriousness in preparing the original estimates for the project.

16. 2.62 -do-

Another explanation given for the variation between the initial estimate and the final sanction is that whereas the initial estimate was only for placing the indent for plants on DGS&D, the final sanction was for actual contract price of the plants, fuller details of civil works, erection and commissioning costs, utilisation and acid mixing facilities. That the final sanction should be for an amount almost double of the initial estimate is a sad reflection on project estimation.

17. 2.63 -do-

The contract for the procurement of plants was concluded in November, 1971 but the sanction for the project as a whole was accorded in July, 1973. Thus, it took the Department of Defence Production nearly 18

months to collect the necessary details for according sanction. The Committee consider this as an unduly long period. They feel that if the sanction could have been issued earlier, the civil works would have started earlier and the Department would not have found itself in the none-too-happy predicament whereunder the execution of the project had to be spilled over the warranty period fixed for the plants.

10.

2.64 -do-

According to the time schedule drawn up by the Director General, Ordnance Factories and given in December, 1971 to the Military Engineering Service (MES) for completion of civil works, the building shell was to be handed over by the MES in 16 months after the issue of administrative approval. In January, 1972, MES authorities indicated that they could not agree to the time-schedule and that completion of shell stage of Phase I and Phase II works would require 25 months and 29 months respectively from the date of issue of administrative approval. The Committee regret the fact that the MES could not be associated by the DGOF while drawing up the time-schedule. The Secretary, Defence Production conceded during evidence that it would have been very desirable if at the time of purchasing the plant itself they were in a position to know precisely the time required by consulting the engineers concerned. He also informed the Committee that in the light of this particular experience his Department was examining how best to streamline the system so as to avoid in future a possible disharmony between the work-calendars assumed by the two parties, viz., DGOF and the MES. While regretting that this was not done in the present case, the Committee hope that a lesson would be learnt from this experience and the procedure in such cases would be streamlined so as to avoid a situation of the type that had developed in this case.

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19.	2.65	Ministry of Defence (Deptt. of Defence Production)	<p>A period of more than two years of the delay in commissioning of these plants is attributable to the defects noticed in the 'blenders'. The work on blenders is stated to have been completed in December, 1974 but during testing in March, 1975, leakages were noticed which had to be rectified. The rectificatory work was completed in June and October, 1976 and at the end of it a final clearance from Vikram Sarabhai Space Centre was obtained. The original cost of construction of blenders was around Rs. 2.70 lakhs. The rectificatory work cost Rs. 2.2 lakhs. The rectificatory work included coating of the blenders with 'epoxy paint'. As the coating is required to be done periodically it naturally would add to the maintenance cost of the plant. The Committee have been told that the blenders are made of RCC instead of steel and that it was for the first time that blenders of RCC were constructed and experimented with in such a big project like this. The Committee would like the Government to compare the expenditure, capital as well as maintenance, on RCC blenders with the expenditure that would have been incurred if the blenders were made of steel, to find out whether the decision to experiment with blenders made of RCC in this project of strategic importance was justified. It should also be examined whether on safety considerations it was worthwhile taking the risk of building RCC blenders instead of having those built of steel. The Committee would like to be informed about the results of the examination. The Committee understand that Vikram Sarabhai Space Centre had recommended certain safeguards while putting the blenders in use. The Committee fervently hope that these safeguards are being followed.</p>

20. 2.66 -do-

The Committee note that in terms of the contract with the suppliers, the warranty periods in respect of plant 'X' (unit I and II) and plant 'Y' (unit I) expired in July, 1976 and July, 1977 respectively. As these plants were commissioned in July, 1977, the benefits of the warranty were not available. The Committee are, however, informed that as a special consideration, the suppliers have extended the warranty period upto December, 1977. Because of what the Secretary, Defence Production, called "our special approach" to the suppliers, Government were able to get a warranty period of 5 months instead of the usual one year from the date of commissioning of the plant. The Committee regret that the factory was not able to enjoy the normal warranty benefit of one year after the commissioning of the plant precisely because of the delay in commissioning.

21. 2.67 -do-

The warranty period of unit II of plant 'Y' is due to expire in February, 1979. For enjoying the full benefit of one year warranty this unit should have been commissioned in February, 1978. However, the unit is at present scheduled to be commissioned from January to May, 1980. This means that warranty benefits in respect of this unit would not be available to the factory at all. This position is fraught with danger as in the even of any defects noticed during trial runs, commissioning and initial working of the unit, no legal remedy would be available against the suppliers. It is a sad reflection on the poor planning and listless execution of the project. The Committee would like the Department to investigate as to how his situation has come to develop with a view to fixing responsibility, and take such remedial measures as may be possible at this stage.

22. 2.68 -do-

Another field in which lack of perspective planning is discernible is the water supply for the plants. The sanction for the project issued in July,

1973 included a provision for treatment and filtration of water. The work against this sanction was completed in July, 1975. Meanwhile, the requirement of water was re-assessed in April, 1974 and it was found that in addition to the existing scheme, an additional supply of 27 lakh gallons was required. The sanction for the new scheme was sought in August, 1974 and accorded in July, 1975. The new scheme was originally scheduled to be completed by May, 1978. The Committee, however, find that the new scheme (comprising of desilting of a lake) is "expected to be completed by September, 1969". The Department has sought to minimise the implications of the delay in the execution of the scheme by stating that the scheme "was necessarily independent of the decision to procure plants 'X' and 'Y'" and it was "an adequate insurance against dry spells encountered in (the area) and to ensure supply of raw water during lean periods." The Department have, however, in another note furnished to the Committee, themselves pointed out that "the quantum of raw water available and purification facilities were/are adequate for phase I when commissioned in July, 1977 and for running the factory at about 50 to 60 per cent of full capacity." The Committee regret that the requirements of water were not assessed properly at the time of issue of comprehensive sanction in 1973. They would like the Department to enquire into the reasons for the anticipated delay in the completion of the scheme for augmentation of water supply of nearly 16 months.

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2.69

Ministry of Defence
(Deptt. of Defence
Production)

Now, that the revised target of September, 1979 has been laid down for the completion of the project, the Committee hope that all efforts would

be made to complete the work by the target date. The completion of the scheme by the new target of September, 1979 assumes added importance in the context of commissioning of unit II of plant 'Y' scheduled from January to May, 1980 by which time the availability of water should be adequate to enable the plants being run to optimum capacity.

24. 2.72 -do-

Modernisation of mixed acid system was another scheme forming part of the project which was not thought of at the time of projecting the proposals for modernisation of processes of production in the factory in May, 1970. Consequently, 'operational' indents placed by the DGOF on the DGS&D in June, 1970 did not include the acid mixing plant. The proposal for modernisation of the acid mixing plant could not be mooted earlier than 1972. The Department have sought to explain this lack of foresight by stating that "even with the best possible planning and technical knowledge some unforeseen problems do arise whenever modernisation of a factory, more especially a chemical plant producing diverse set of product mix, is undertaken." The Committee are not convinced and they regard this as a lapse on the part of the Department.

25. 2.71 -do-

Even after the idea was mooted in 1972 it took nearly two years thereafter for the contract to be concluded by the DGS&D. The civil works for the plant were completed in January, 1976 and the plant was erected in May, 1976. The justification offered for the delay that "it was necessary to have preliminary technical discussions/clarifications with the firm and select suitable supplier" is not sufficiently convincing. The Committee feel that by advance planning and energetic action the time taken could have been curtailed and the acid mixing plant could have been erected earlier than

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May, 1976. The Committee hope that the Department of Defence Production will give due deference to the snags highlighted in this report and so streamline the project planning and execution procedures as to make for a synchronised and coordinated effort leading to planning and execution of the projects according to a well laid-out programme.

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