

SHORTCOMINGS OF GENERAL NATURE OBSERVED DURING INTENSIVE EXAMINATION OF WORKS/CONTRACTS



***CHIEF TECHNICAL EXAMINER'S
ORGANISATION***

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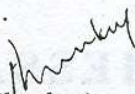
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MESSAGE

Punitive action alone need not be the main function of vigilance organisations. 'Prevention is better than cure' is a common adage, which is very relevant in the working of all Government organisations. Adherence to management policies and procedures in all areas, particularly in the award and execution of works/ contracts is of vital importance to all the organisations. CTE organisation, in the Commission has been making a very positive contribution in this area not only by conducting systematic examination of works/ contracts but has also issued various booklets, highlighting the common lapses along with guidelines to deal with these deficiencies in contracts. However, certain irregularities of general nature, persist in most organisations. The common shortcomings observed in contracts along with guidelines to deal with these have been brought out in this publication in a very lucid and illustrative manner. We are sure the executives of all Government organisations and PSUs will find this booklet very useful. This shall help them making the contract management more efficient and transparent.

We highly commend the efforts put in by the Chief Technical Examiner and his inspection teams in bringing out this booklet.



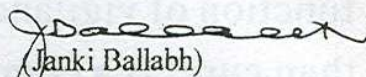
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Central Vigilance Commissioner



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Vigilance Commissioner

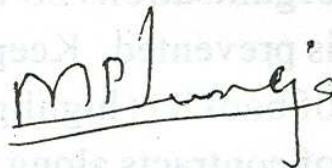
PREFACE

The shortcomings observed during the course of intensive examination of various works/contracts by CTE Organisation are brought to the notice of CVOs for suitable corrective action. While the pre ponderant objective of such examinations is to detect malpractices in the award and execution of works/contracts, it has also been our endeavour to help improve the systems in the organisations so that recurrence of such shortcomings is prevented. Keeping this perspective in view, a number of booklets highlighting common lapses in various types of contracts along with guidelines for improvement have been issued by the Commission. In addition, we have also issued circulars on specific issues like 'appointment of consultants' and 'award of contracts on back-to-back basis' etc. in the recent past. The level and extent of interaction with the officials, during inspections has also been stepped up.

However, it is observed that certain common irregularities continue to plague the system in a large number of organisations. Any mismanagement in the award and execution of works/contracts not only results in heavy leakages of revenue but also adversely affects the image and profitability of the organisation. With a

view to contain malpractices and make the process of contract management more transparent and efficient, this small booklet in the form of a ready reckoner is being issued. The important issues have been itemised and explained with illustrative examples of recent inspections. It is expected that this 'yet another' booklet shall help improve the procedures and systems in the organisations and make contract management more transparent and effective.

Any omission or suggestion may please be brought to the notice of the undersigned.



(M.P. JUNEJA)

Chief Technical Examiner

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April, 2004

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PROJECT GENESIS

- ❑ Formulation of a project proposal generally forms the first step in the process of undertaking a work. Organisations, as has been noticed undertake works, at times without clearly examining the need & viability for this. Modern management techniques like pay back period, discounted cash flow, NPV, IRR, technical and market analysis, etc. are not utilized. With the opening up of the Indian economy to national and global competition, failure to examine the fluid market scenario can result in wasteful and infructuous expenditure which may adversely affect the viability of the project and bleed the balance sheet.
- A steel PSU processed a case for supply & installation of certain equipments for upgradation of their plant. After having finalized the tenders, the contractor was allowed to supply the equipments. In the meantime the PSU dropped the original proposal to upgrade the plant resulting in the junking of material worth several crores of rupees. Thus before acting on a proposal, the requirements need to be thoroughly examined taking the long term aspects into consideration.
- In another case, a Port Trust, while replacing the existing wharf cranes of 3 tonne and 6 tonne capacity, decided to go in for 10 tonne capacity cranes. On analysing the cargo handled in the preceding years as also the future

projections, it was revealed that the majority of the cargo was within 3 tonne capacity. Thus the procurement of 10 tonne cranes turned out to be a case of gross over-provisioning. Ironically, the cargo handling efficiency of the port was also affected considerably due to the sluggish operation of the larger cranes in comparison with the lighter 3 tonne cranes. Thus the upgradation, conceptualised without an objective and comprehensive study resulted in gross under-utilisation of the capacity of the port.

- In a recent inspection it was noticed that a shipyard PSU initially quoted US \$ 24.5 million for the construction of tugs to a foreign client and then scaled down the bid to US \$ 18.5 million on request from the clients. The total cost of tugs to the PSU itself worked out to Rs 114.50 crores. After considering 30 % subsidy likely to be available from the government, the realization at their quoted price worked out to Rs 115.45 crores indicating a measly profit of Rs.0.95 crores. However, on reassessment the PSU found that the contract would result in a loss of Rs 6.39 crores due to fluctuations in foreign exchange rates. Presently the supply of tugs is being made to the foreign client at a substantial loss even after considering the likely subsidy of 30 % from the government.
- As per the cost benefit analysis done by one of the banks, a minimum of 200 financial transactions per day per ATM were required to make them economically viable. However, during inspection it was noted that in several branches of the Bank even after expiry of one year of installation of ATMs, there were hardly any transactions.

ROLE OF CONSULTANT

❑ The Commission through its OM no OFF1 CTE1 dated 25th Nov, 2002 issued a detailed guideline on appointment of consultants along with certain irregularities noticed during the intensive examinations. However, consultants continue to be appointed either without a genuine need or in an arbitrary and non-transparent manner. Once the consultant is appointed all the responsibilities are abdicated to him. Some times even multiple consultants are appointed without well defined responsibilities. The proposals of the consultants are accepted without question and even considered deemed approved without any scrutiny. The payment terms also remain lax and open ended leading to undue advantage to the consultant.

- A consultancy PSU, which had provided consultancy for hundreds of projects to other public sector/private organisations, appointed a consultant for the construction of their own office building.
- In another case, a power sector PSU, in addition to appointing a project consultant and a project management consultant, appointed one 'inspection & expediting' consultant, inspite of having an elaborate engineering set up in their own organisation.
- A public sector bank appointed a consultant in Aug 2000 on retainership basis at a fee of Rs 45000/- per month for 5 days in a month upto a period of one year without following established procedures of selection. In addition the expenses on travel, boarding and lodging

were to be reimbursed by the bank on actual basis. The contract was repeatedly extended up to February, 2004 at a monthly fee of Rs 27000/pm (for putting in 3 man days a month). The payments to the consultant were not linked to any work progress and no penalty clauses were kept in the agreement for safeguarding against defaults by the consultant .

- In a case of rehabilitation of a sick fertiliser PSU, the consultancy contract for the revamp project was awarded on a single tender basis to a consortium of a PSU and their foreign associates at Rs.22.5 crores against the approved estimated cost of Rs.10.58 crores
- In a classic case, a PSU consultant submitted detailed estimate and invited tenders for an electrical job in an Oil PSU suiting 11 KV supply, but after award of the work it was found that only 22 KV supply was available at the site. Major modifications had therefore to be carried out in the contract. Strangely, the consultant was also permitted to quote for the same work for which they had themselves estimated the rates. More bewildering is the fact that the consultant quoted 20% above their own estimated rates (on the basis of which NIT was floated), as against the awarded rates which were 20% below the estimated cost. Such over-dependence on the consultant can lead to wasteful and infructuous expenditure which the organisation regrets in the long run. Meticulous and intelligent examination of the consultants proposal is therefore essential for successful and viable completion of the project.

ESTIMATES

❑ Incorrect estimation is another common deficiency observed during the inspections. The estimated value put to tender at times is at a large variance vis-a-vis the awarded contract amount. Sketchy estimates, incorrect estimation of quantity/rates, unrealistic assumptions and lack of market survey have been found to be the major reasons for this deficiency. In some cases it was noticed that, in order to award the work at high rates, the estimates were padded up to match the quoted rates by incorporating untenable factors.

➤ An oil PSU recently called tenders for a work running into crores of rupees on the basis of a half page estimate prepared by their consultant. When the lowest tendered rates did not match the estimated rates even after obtaining revised price bid, the estimates were jacked up by 20 % to justify the quoted rates in order to award the work.

➤ In another oil PSU for a work costing about Rs 1100 crores, detailed estimate was not prepared and work was awarded based on a single page estimate, initially prepared for the sanction of the project.

- In another case of a highway project, provision of 35% contractor's profit and overheads was made in some items of the estimate as against the traditional 10-15%, resulting in an unrealistic and inflated estimate.
- One Government Organisation, for the work of construction of water treatment plant (WTP), made a Rs 69 crores estimate based on the cost of existing WTPs. The PQ criteria were formulated in such a way that only two bids were received. The lowest offer received was for Rs.188 crores against the estimated amount of Rs.69 crores. The plea given for this abnormal difference was that the proposed plant was based on some new technology. No documentary evidence was however produced to justify this cost difference. The department officials did not even bother to obtain the rates of the so called 'new technology' based WTPs installed elsewhere in the country. Furthermore, the department preferred not to resort to any price negotiation with the L-1 bidder and instead recorded that, there was no need to hold any negotiation in this case.

AWARD OF WORK

□ In spite of a plethora of guidelines issued by the Commission on various aspects of tendering, organisations continue to embark upon limited tendering, selective publicity and fixation of arbitrary PQ criteria to suit certain firms. Many instances of arbitrary and non-transparent selection/rejection of firms through pre-qualification have been noticed. Such procedures are replete with risks of lower competition, cartel formation and higher rates. Giving sufficient time to bidders for market survey and evaluation is also essential especially for large projects.

- In the case of a communications organisation, PQ criteria of 'Completion of 5 works of similar nature in Govt. organisations only' was kept as a minimum requirement leading to majority of the contractors being disqualified.
- In a recent inspection of a PSU for the procurement of HDPE bags, it was noted that prequalification criteria for selection of vendors was decided after opening of the tenders. Further, the criteria decided was discriminatory as it specified the manufacturing capacity of the vendors located in nearby states as 20,000 bags per day vis-à-vis 70,000 bags per day for the vendors located in other states.

➤ In a large value work for laying of High Tension Line, one bidder was prequalified by the PSU and awarded the work, though the firm was not meeting the pre-qualification criteria. As per the PQ conditions, the prospective bidder was required to have executed one work of minimum 200 Kms of similar transmission line. Against this requirement, the bidder submitted experience of four separate contracts of 15 Km, 71 Km, 74 Km and 40 Km. which was accepted and contract awarded to this bidder.

❑ The amount of Earnest Money deposit kept in the tender document is sometimes abysmally low ranging from NIL to Rs. 1,00,000/- and bears no relationship with the estimated cost of the work which may run into crores of rupees. The small amount of EMD proves to be too low for safeguarding the interest of the organisation.

➤ In a recent inspection of a shipyard PSU, it was noticed that limited tender inquiry was issued to select vendors, without any basis. No EMD was kept in the tender. Tender negotiations were conducted with L-2 bidder and the work awarded to them in violation of CVC instructions. However the firm backed out after award, without any financial repercussion, due to lack of EMD provisions in the tender. The tender had to be cancelled.

In the second round the L-1 bidder withdrew the offer due to fluctuations in the prices. A conditional letter of intent subject to conformation of prices by the steel manufacturer was issued to L-2. The firm did not agree to furnish the security money and were also not willing to accept the LD clause. The LOI was again cancelled without any financial penalty on the firm. Ultimately the tender inquiry was put on the company's web site and work awarded to the single late bidder. Having provision of adequate amount of EMD safeguards the interest of the organisation and keeps the non-serious and speculative bidders at bay.

❑ Govt. Organizations continue to dole out interest free mobilisation advances to the contractors, in clear violation of the Commission's guidelines.

➤ One organisation was noticed to have gone a step further and given interest free mobilisation advances not only to its contractors but also to its engineering consultant, the PMC and the inspection and expediting consultant. In the event of a delay in work, the contractors/consultants tend to enjoy the interest free advances at the cost of the government and may even stand to earn money on the free resources.

➤ Additional interest free 'equipment advance' amounting to Rs 15 crores was paid to the contractor

in a power project on the basis of deviation in the contract without any specific provision in the contract resulting in extending undue financial benefit to the contractor.

- Interest free equipment and mobilization advance amounting to Rs. 45.00 crores was lying with contractor in a highway project without any bonafide use in the project, as the progress achieved was only 15% against the targetted progress of 55%.
- ❑ The tender documents should carry all relevant information in an explicit manner. The criteria of evaluation for identifying the lowest bidder should be clearly stated and the irrelevant and non applicable clauses of the tender should be crossed out. All bidders must be brought at par techno-commercially before opening of the price bids. Objective and market based justification of rates must be prepared before award of the work/contract.
- A work costing about Rs 800.00 crores was awarded to an ineligible PSU on nomination basis, over-looking the claim of another eligible PSU. The awardee PSU in turn, awarded the major portion of the work to a private contractor on back to back basis without inviting open tenders, resulting in award of work to the contractor without competition.

- In a work of laying of optical fiber cable in the State of Maharashtra, one central PSU distributed the work into various Telecom Districts and awarded the work in such a manner that all the participating private firms could get at-least one route for cable laying. No genuine competition was generated and as a result the rates of cable laying varied from Rs.260/- to Rs.580/- per meter on different routes. The organisation thus failed to ensure techno-commercial correctness of the offers before awarding the works leading to a wide variation in rates.
- For sale of Pig Iron by a steel sector PSU, the sole dealer was selected through a draw of lottery. After initially awarding the contract for a period of 3 months, four extensions of 3 months each were given to the contractor covering a total quantity of 2,87,809 MT as against 50,000 MT originally envisaged in the contract. There was no provision in the original contract for such extensions and the decision smacked of favouritism. During the extended period, the contractor enjoyed monopoly status in the market.
- In another case, a central PSU entered into a pre-bid tie-up with a private manufacturer of DI pipes, for participating as a lead partner in a bid for a state government project. At the same time the private

manufacturer also participated independently for the same bid. Interestingly in the contract between the state government and this PSU, there was a penalty clause for delay in completion with a maximum penalty of 7.5% but in the pre-bid tie-up between the PSU and the private manufacturer, there was no such clause for penalty for delay in supply of DI pipes. Moreover, 100% payments were made by the PSU to the pipe manufacturer on supply whereas the state government was paying only 75% against supply of items. In the process the PSU made 25% extra payments over long periods of time. Further, the PSU kept no security or bank guarantee to safeguard its interest in case the pipes were found defective or failed during testing. Thus the PSU while extending all safeguards to the client failed to protect its own interests in the pre-bid tie up with the private manufacturer.

POST AWARD ACTIVITIES

- ❑ A common irregularity noticed during inspection is the acceptance of post award requests of contractors which are in variance with the tender provisions, e.g. for getting the contract split into supply and works contracts. Though these innocuous looking requests may appear to have no repercussions on the PSU, the contractor is seen to benefit tremendously by avoiding taxes like WCT etc on the modified contract.
- In one such case a fertilizer PSU split up the work of electrification into separate supply and works contract on the awardee's request. This not only led to huge savings for the contractor on account of undeducted WCT, but also left the organisation saddled with unwanted material, which was received as a part of supply contract but was not installed due to site limitations.
- In a recent case, a PSU bank accepted the post LOI condition of the bidder for payment of service tax in addition to the quoted prices for the operation and maintenance work of a new AC plant, though the tender specified all inclusive quote from the bidder.
- ❑ Some organizations do not maintain the contract documents in a proper manner. The agreement which

consists of the bill of quantities, technical and commercial conditions, technical negotiations, price bid, LOI/LOA is a legal document and forms the Magna Carta between the two parties. The documents should be well bound, paginated, secured and signed by both the parties and kept in a manner that possibilities of tampering and interpolation are eliminated.

➤ In a recent case, it was seen that bidders, who never returned the tender documents during submission of bids, were also considered for award of work. Further some of the documents listed in the (stamp paper) agreement were not available with the PSUs, so much so, these had to be obtained from the contractor.

❑ All post award deviations have some financial implication or the other and should be avoided. Organizations routinely accept the innocuous looking requests of contractors without meticulously going into the proposals or taking into consideration any financial implication. This has usually resulted into undue financial benefit to the contractor.

➤ In the case of a pre-bid tie-up between a central government PSU and a private manufacturer of DI pipes, the original agreement envisaged supply of pipes from Calcutta works on FOR destination (Bangalore) basis. The rates of the manufacturer were based on this condition. But at the time of execution of contract, the

manufacturer proposed to supply the pipes from their Tirupati works to Bangalore. The PSU readily agreed to this proposal without considering any financial implication, though the private firm saved considerably on freight due to this change.

➤ In a jetty project, retention money was released to the contractor against bank guarantee without any such provision in the contract. The above resulted in undue financial benefit to the contractor to the tune of Rs. 70 lacs.

❑ Another deficiency noticed during inspections is that the contract document is not properly studied and implementation of contract clauses is lax. Clauses of insurance, workmen compensation, labour licences ESIC etc are routinely neglected, giving huge financial benefit to the contractor.

➤ In a big hydel-power project, it was found that insurance of the construction plant and equipment was only partially obtained resulting in an undue benefit to the contractor to the tune of Rs.6 crore. This amount was recovered from the contractor after inspection by the CTEO.

❑ The importance of site documents continues to be overlooked. Records of measurement, hindrance, site instructions, testing are either not prepared or made as a

formality. While making running payments the locations of measurement is not recorded, LD is not imposed for vague reasons since no record of hindrance is maintained. The basic essence of the contract to complete the work in time is ignored, even to the extent that in some cases payments were released much beyond the completion period without extending the agreements.

- In one oil PSU work, formal agreement with the contractor was entered into after a lapse of more than 1 1/2 years that too after prolonged correspondence including negotiation in rates, but the payments were regularly released by the PSU without any agreement.
- No logbook for recording details such as time and date of failure, nature of failure, time of reporting and time of restoration etc. was maintained by the branches of a bank at most ATM's. In the absence of the same, it would not be possible for the bank to claim routine penalty against downtime etc. from the contractor, as per the provisions of the contract.