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CAG AUDIT REPORT ON TURNAROUND PLAN AND FINANCIAL RESTRUCTURING PLAN OF AIR INDIA LIMITED PRESENTED IN PARLIAMENT

The Comptroller & Auditor General of India Audit Report No. 40 of 2016 on Turnaround Plan and Financial Restructuring Plan of Air India Limited was tabled in Parliament today.

Air India Limited, wholly owned by the Government of India, is engaged in Domestic as well as international air transport operations. Difficulties of aviation industry in recent years, coupled with operational problems of the Company strained the financial position of Air India Limited. The high debt burden of the Company further reduced its liquidity and the Company lost significant market share in recent years. The Company formulated a comprehensive Turnaround Plan (TAP) which was approved (12 April 2012) by the Cabinet Committee on Economic Affairs.

The Turnaround Plan identified specific milestones to be achieved in various functional areas as well as operational areas of Air India. The milestones were linked to release of equity by Government of India (GoI).

This Report examines the implementation of the Turnaround Plan and Financial Restructuring Plan of AIL. Audit included the assessment of the operational and financial management of AIL, during 2010-16, with a focus on its TAP. Status of implementation and achievement of the milestones/objectives set by the TAP in major financial and operational areas are highlighted below.

1. **Financial Restructuring:** The Financial Restructuring Plan of AIL had envisaged that AIL would achieve positive Earnings before Interest Tax Depreciation and Amortisation (EBITDA) by 2012-13. Though AIL reported a positive EBITDA of ₹166 crore

(April-December 2014) from a negative ₹191 crore (April-December 2013) both statutory auditors and CAG of India had expressed qualified opinion on the accounts of AIL for all the three years (2012-13 to 2014-15) pointing out significant understatement of losses in the financial statements presented by the Company. The understatement of losses were ₹1455.8 crore (2012-13), ₹2966.66 crore (2013-14) and ₹1992.77 crore (2014-15). Considering the effect of these qualifications on the financial statement, the EBITDA of AIL would be negative (up to March 2015).

2. **Operational Performance:** There was shortfall in achievement of TAP targets relating to operational performance of the Company relating to on-time performance (OTP). As against the target to improve OTP from 71.7 *percent* (October 2011) to 90 *percent*, AIL could achieve OTP of 78 *percent* in 2015-16.

However, AIL was able to achieve the target set by the TAP for Passenger Load Factor (PLF)and Network Yield.As against the target to achieve Passenger Load Factor (PLF) of 73.4 *percent* by 2016 and 75 *percent* by 2020, AIL was able to achieve overall PLF of 75.8 by the end of FY 2015-16.The TAP target for Network Yield was ₹3.76 per Passenger km and ₹3.75 per passenger km during 2014-15 and 2015-16 respectively against which AIL could achieve Network Yield of ₹4.27 per passenger km and ₹4.0 passenger km in the respective years.

3. **Aircraft Utilisation:** Utilisation of aircraft by the Company during the period of audit was substantially low. Against the TAP target of 12.25 hours of utilisation for narrow body aircraft, the actual utilisation was 9.57-10.57 hours in 2014-15 and 9.22-11.16 hours in 2015-16. Similarly, against a TAP target of 13-15 hours for the same period for wide body aircraft, the Company could achieve only 2.04-12.94 hours in 2014-15 and 6.89-12.07 hours in 2015-16.

Audit also noticed that deadlines of certain milestones viz. Productivity Linked Incentive (PLI), operationalisation of MRO/GH, IT system, monetisation of assets etc. had already expired before the period of approval of TAP/ FRP.

4. **Human Resources:** The Turnaround Plan (TAP) intended to stop the payment of Productivity Linked Incentive (PLI) till AIL generated Profit Before Tax (PBT). TAP also required that a Voluntary Retirement Scheme (VRS) be worked out by the end of December 2011. However, AIL failed to fulfil these requirements as a significant component of PLI continued to be paid as ‘adhoc pay’. AIL had decided not to implement VRS.

5. **Hiving Off Subsidiaries:** Subsidiaries for MRO and Ground Handling (GH) were required to be operationalised by January 2012. As against this target date, the MRO subsidiary was operationalised only in January 2015 and GH subsidiary in April 2014.

6. **IT Integration :** As per Turnaround Plan, AIL was required to implement IT systems for ticket pricing and sales, network planning, crew scheduling and operational efficiency by December 2011. However, till March 2016 though, the remaining systems were in place, AIL could only partially implement the Central Planning and Control System and the Flight Planning System.

2. Audit Findings

Significant Audit findings of the report in the financial and operational areas are summarized below.

2.1. Financial Restructuring:

- AIL sold five B-777-200 LR aircraft and utilized the sales proceeds to liquidate the outstanding loan amounting to ₹1804.96 crore. However, the equity commitment of Government of India towards repayment of aircraft loans (during 2014-15) had not been adjusted to account for the premature liquidation of aircraft loan taken for five aircraft.

(Para 3.3.1)

- AIL exceeded the Financial Restructuring Plan (FRP) limit which resulted in availing of additional short term loans due to failure in generating projected revenue, non-achievement of asset monetization target, increase in staff costs due to delay in operationalization of subsidiaries and non-implementation of recommendations of Justice Dharmadhikari Committee, for harmonization of wages and increase in interest charges.

(Para 3.4.1)

- AIL failed to achieve the annual target of ₹500 crore for monetization of property, mainly due to improper selection of properties (deficiencies in ownership/ conditions attached to the ownership, utilized by the company for its own use). Only six properties had been put up for e-auction, out of which only two properties were sold.

(Para3.5.1,3.5.2 and 3.5.3)

2.2. Availability of Aircraft:

- A month after last B-777-200 LR aircraft was delivered, AIL decided to lease out three aircraft in view of the likely surplus capacity of wide body aircraft likely after receipt of B-777-300 ERaricraft. Leasing didnot materialiseand the surplus capacity led to operational losses of the airline. With the decision to utilise B-777 ER aircraft with re-despatch method for long haul operation, the B-777-200 LR aircraft, which were initially procured for long haul operation, were rendered redundant**.**

(Para 4.2.1)

- AIL sold five 777-200 LR aircraft to Etihad Airways at a price significantly lower than the indicative market price of USD 86 to 92 million per aircraft.A second valuation exercise was carried out after opening the financial bids and the market value of the aircraft could not be realised in the sale.

(Para 4.2.2 and 4.2.3)

- Though AIL was aware of the shortage of narrow body aircraft as early as May 2010, it delayed leasing of A-320 aircraft. This resulted in non-availability of aircraft as targeted. Against the requirement of 19 aircraft, the Company inducted only five aircraft till March 2016.

(Para 4.3 and 4.3.1)

2.4. Deployment and utilization Aircraft

- Deployment of aircraft (both wide body as well as narrow body) remained low due to grounding of aircraft for considerable period. Main cause of grounding of AIL aircraft was non-availability of spares, leading to cannibalisation of spares from one aircraft to another, compounding the grounding period and loss of flying hours.

(Para 5.1 and 5.4)

- AIL could not achieve the targets in Turnaround Plan for utilisation of available fleet (wide body as well as narrow body) in terms of hours to be flown. Low utilization was also on account grounding of aircraft for prolonged periods.

(Para 5.3A and 5.5.2)

- Excess of weight of the B-787-800 aircraft by ten tons over the prescribed weight resulted in additional fuel consumption. AIL calculated the likely loss on additional fuel consumption at USD 400 million. The procurement contract did not have adequate safeguards to enforce compensation and as such the company had to resort to negotiation. The supplier, M/s Boeing refused to negotiate the ceiling on compensation but offered negotiation in good faith.The total compensation received worked out to USD 71 million inclusive of the fuel-burn guarantee under Purchase Agreement.

(Para 5.3.1)

2.5. Management of bilateral agreements and slot management:

- Enhancement in bilateral entitlements between India and foreign countries resulted in excess capacity being allowed in bilateral entitlements compared to genuine traffic requirements. This enhancement led to the foreign airlines availing 6^{th} freedom traffic to fly from one foreign country to another using their own country as a hub thereby impacting the interest of AIL. 6^{th} freedom traffic constituted 59 *percent* and 61 *percent* of total carriage of airline passengers of the country for the year 2014-15 and 2015-16 respectively. Enhancement of bilateral entitlements had greater impact on operations in Gulf sector particularly Dubai and Abu Dhabi. ***(Para 6.1)***

- Conversely, though AIL utilised 100 *percent* of the allocated capacity of bilateral entitlements with 13 countries, it did not take efforts to enhance these allocations or to provide for future enhancements in capacity, despite increase in fleet size.

(Para 6.1.3.2)

2.6. Network and Route Strategy:

- AIL was able to operate only a single hub at Delhi as against the envisaged hubs at Delhi and Mumbai, even after four years of approval of TAP. AIL had also moved away from the TAP strategy of launching of 'Indian Shuttle Service' to utilise all economy narrow body aircraft to target new passenger segment.

(Para 7.1 and 7.2)

- AIL achieved surplus over variable cost in 2012-13. This surplus over variable cost increased from ₹686 crore in 2012-13 to ₹4103 crore in 2015-16. AIL however failed to generate surplus to meet the total cost, the deficit over total cost being

₹5514 crore in 2015-16. Operations in international sector was the major contributor to the overall deficit.

(Para7.4)

2.7. Human Resource Management Initiatives:

- Milestones that AIL had to achieve for release of equity included ceasing of payment of Productivity Linked Incentive till the achievement of Profit Before Tax by AIL. Despite directions of CCEA to stop payment of PLI till the time AIL could generate profit before tax, AIL made payment of ₹734 crore being 75 *percent* of PLI to the employees as adhoc pay.

(Para 8.1.A)

- In contravention of the recommendations of Justice Dharmadhikari report, AIL approved promotion of 2482 managerial employees, allowed accommodation of crew in five star hotels leading to excess expenditure and extended free passage to family members.

(Para 8.2)

2.8. Hiving off of Maintenance Repair and Overhaul and ground handling business to subsidiaries:

- The hiving off of the activities of Maintenance Repair & Overhaul (MRO) services and Ground Handling services to subsidiaries was envisaged by 31 March 2012. However hiving off activities of MRO to Air India Engineering Services Limited (AIESL) and Ground Handling to Air India Air Transport Services (AIATSL) were achieved only on 1 January, 2015 and April 1, 2014 respectively, after considerable delay.

(Para 9.1)

2.9. Integration of Information Technology Systems:

- AIL failed to arrange for vital input data and skilled man-power necessary for optimum utilization of the IT Application, Profit Manager, in time. AIL also failed to calibrate the Profit Manager System necessary for a meaningful output. This rendered the expenditure incurred on the procurement of input data, infructuous.

(Para 10.4)

- The Crew Management System (CMS), a key component of Central Planning and Control System (CPCS), to be implemented by Commonwealth Games October 2010, was yet to be implemented by the contracted solution provider forcing AIL to adopt an alternate inferior solution as an interim measure. The delays were attributable to absence of timely follow-up by AIL and penalty clause for delays in the Contract.

(Para 10.5)

2.10 On Time Performance:

- AIL was to achieve an overall On Time Performance (OTP) of 85 *percent* in 2012-13 and 90 *percent* by 2013-14. However till 2015-16, the target of 85-90 *percent* in OTP had not been achieved. The OTP of AIL improved in 2013-14 to 78 *percent* from 2012-13, but declined sharply in 2014-15 to 72 *percent*, before improving to 78 *percent* in 2015-16. Moreover, OTP of AIL had been lower as compared to the other domestic carriers at Delhi and Mumbai airports both in 2014-15 and 2015-16.

(Para 11.3)

3. Recommendations by Audit

3.1 Significant recommendations made by Audit included the following:

(i) As a result of the considerable erosion of the benefits of financial restructuring due to high volume of short term loans of AIL, the value of which was nearly four times the cash credit limits laid down in the Turnaround Plan–Financial Restructuring Plan (TAP-FRP), the Company and the Ministry may need to reassess the requirement of funds envisaged in the Plan.

(ii) Monetisation of assets which failed to take off in the four years ended 31 March 2016 should be fast tracked. Efforts should be taken to ensure that assets identified for monetisation had proper title deeds and the lease agreements did not contain any limiting provision/conditions impacting their monetisation.

(iii) Considering the acute shortage of narrow body aircraft faced by the Company, the process of leasing additional A-320 aircraft should be expedited. All efforts should be made to eliminate abnormal grounding of aircraft. Considering the significant expenditure of the airline on lease rent (for leased aircraft) and finance cost (for owned aircraft) for the period the aircraft were grounded, effective action should be taken for optimising the stock of spares, parts,

components and serviceable engines required for repair and maintenance of the acquired fleet. Utilisation of aircraft, particularly the narrow body aircraft should also be improved to meet targets prescribed in TAP and contribute to higher revenues for the airline.

(iv) The Company should focus on recovery of total cost of operation rather than variable cost alone for an effective turnaround for the airline. Rationalisation of routes should be continued. Concerted efforts should be made for maintaining and improving the market share of the airline, particularly on routes where the presence of AIL has been traditionally strong.

(v) The recommendations of Justice Dharmadhikari Committee on harmonisation and rationalisation of staff costs should be implemented by AIL in letter and spirit. The excess manpower compared to the standard force fixed by the Company needed to be rationalised and the practice of hiring of temporary manpower should be reviewed. The crew should be optimally utilised and their availability should be aligned to the station of their operation to address crew shortages leading to poor On Time Performance (OTP), re-scheduling, cancellation of flights. AIL should also rationalise costs on Staff on Duty (SOD) travel, related allowances and hotel expenses in positioning the staff.

(vi) The IT application Central Planning and Control System (CPCS), should be fully implemented expeditiously. Efforts should be made for development and retention of trained manpower for operating these sophisticated IT systems.

(vii) Systems should be put in place for better coordination of crew and more efficient maintenance of aircraft so that delays, re-scheduling and cancellation of flights are minimised.

(viii) Since equity commitment of GoI is specific to identified purposes, equity releases of Government of India (GoI) should be adjusted to match the reduction of loans of AIL guaranteed by GoI and the lower interest liability on non-convertible debentures issued by AIL.

(ix) Considering the significant equity funds committed by GoI to AIL, a decision regarding grant of additional bilateral rights to foreign carriers should take into consideration its impact on AIL, as recommended by the Public Accounts Committee of Parliament in its 93rd report (2013-14).