

CHAPTER I: INTRODUCTION

1.1 Profile of the audited entities

This report relates to matters arising from the compliance audit of transactions of the Ministry of Defence (MoD) and the following organisation under its administrative control:

- Army,
- Inter Services Organisations,
- Defence Research and Development Organisation and its laboratories dedicated primarily to Army and Ordnance Factories,
- Border Roads Organisation,
- Defence Accounts Department,
- Ordnance Factories

Ministry of Defence, at the apex level, frames policies on all Defence related matters. It is divided into four departments, namely, Department of Defence, Department of Defence Production, Department of Research and Development and Department of Ex-Servicemen Welfare. Each department is headed by a Secretary. The Defence Secretary who is the Head of the Department of Defence also coordinates the activities of other departments.

Indian Army is mandated to safeguard National Interests from External Aggression and Internal Subversion. Army is primarily responsible for the Defence of the country against external aggression and safeguarding the territorial integrity of the nation. It also renders aid to the civil authorities at the time of natural calamities and internal disturbances. It is, therefore, incumbent upon the Army to suitably equip, modernize and train itself to meet these challenges

The Inter Services Organisations, such as Armed Forces Medical Services, Military Engineer Services (MES), Defence Estates, Quality Assurance, *etc.*, serve the Defence forces in the three wings of the Army, Navy and Air Force. They are responsible for development and maintenance of common resources for optimising cost-effective services. They function directly under Ministry of Defence.

Defence Research & Development Organisation (DRDO) works under Department of Defence Research and Development of Ministry of Defence. DRDO dedicatedly working towards enhancing self-reliance in Defence Systems and undertakes design & development leading to production of world class weapon systems and equipment in accordance with the expressed needs

and the qualitative requirements laid down by the three services. DRDO, through its chain of laboratories, is engaged in research and development, primarily to promote self-reliance in Indian Defence sector. It undertakes research and development in areas like aeronautics, armaments, combat vehicles, electronics, instrumentation, engineering systems, missiles, materials, naval systems, advanced computing, simulation and life sciences.

Border Roads Organisation (BRO) headed by Director General of Border Road (DGBR), is responsible for construction, development, improvement and maintenance of roads in border areas. BRO functions under Border Roads Development Board (BRDB) in the MoD which is headed by Raksha Rajya Mantri (RRM).

Ordnance Factory Board (OFB) functions under the administrative control of the Department of Defence Production and is headed by Director General, Ordnance Factories. Forty one factories are responsible for production and supply of ordnance stores to the armed forces.

1.2 Authority for audit

The authority for our audit is derived from Articles 149 and 151 of the Constitution of India and the Comptroller and Auditor General's (Duties, Powers and Conditions of Service) (DPC) Act, 1971. We conduct audit of Ministries/Departments of the Government of India under Section 13 of the CAG's (DPC) Act. Major Cantonment Boards are audited under Section 14 of the said Act. Principles and methodology of compliance audit are prescribed in the "Regulations of Audit and Accounts, 2007".

1.3 Audit methodology and procedure

Audit is prioritised through an analysis and evaluation of risks so as to assess their criticality in key operating units. Expenditure incurred, operational significance, past audit results and strength of internal controls are amongst the main factors which determine the severity of the risks. An annual audit plan is formulated to conduct audit on the basis of risk assessment.

Audit findings of an audited entity are communicated through Local Test Audit Reports/Statement of Cases. The response from the audited entity is considered which may result in either settlement of the audit observation or referral to the next audit cycle for compliance. Serious irregularities are processed as draft paragraphs for inclusion in the Audit Reports which are submitted to the President of India under Article 151 of the Constitution of India, for laying them before each House of Parliament. Performance Audits are done through structured exercise by defining scope of audit, holding entry conference, sampling of units, exit conference, inclusion of feedback on draft report and issuance of final report.

1.4 Structure of the Report

This report contains seven chapters comprising six performance reviews and 22 audit paragraphs based on the audit of financial transactions of Ministry of Defence pertaining to Army, Inter Services Organisations, Border Roads Organisation, Defence Research and Development Organisation, Defence Accounts Department, Ordnance Factories.

1.5 Financial aspects and Budgetary Management

1.5.1 Introduction

The budgetary allocations for 2015-16 of the Ministry of Defence are contained under eight Demands for Grants of which six Grants are included under Defence Service Estimates (DSE) and two under Civil Grants.

- Two Civil Grants are Demand No. 21 - Ministry of Defence (Civil) and Demand No. 22 - Defence Pensions.
- Six Grants of Defence Service Estimates (DSE), which include the following:
 - Demand No.23, Defence Services - Army
 - Demand No. 24, Defence Services - Navy
 - Demand No. 25, Defence Services - Air Force
 - Demand No. 26, Defence Ordnance Factories
 - Demand No. 27, Defence Services - Research & Development
 - Demand No.28, Capital Outlay on Defence Services -Includes All Services and Departments other than those covered by the Demands for Grants of Ministry of Defence (Civil)
- The budgetary requirements for the Border Roads Organisation are provided under Ministry of Defence (Civil) Grant No. 21 from the FY 2015 onwards.

The above mentioned Grants are broadly categorized into Revenue and Capital expenditure.

- **Revenue Expenditure:** This includes expenditure on Pay & Allowances, Transportation, Revenue Stores (like Ordnance stores, supplies by Ordnance Factories, Rations, Petrol, Oil and Lubricants, Spares, *etc.*), Revenue Works (which include maintenance of Buildings, water and electricity charges, rents, rates and taxes, *etc.*) and other miscellaneous expenditure.
- **Capital Expenditure:** This includes expenditure on Land, Acquisition of new weapon and ammunitions, Modernization of Services, Construction Works, Plant and Machinery, Equipment, Tanks, Naval Vessels, Aircraft and Aero-engines, Dockyards, *etc.*

Approval of Parliament¹ is taken for the Gross expenditure provision under different Demands for Grants. Receipts and Recoveries, which include items like sale proceeds of surplus/obsolete stores, receipts on account of services rendered to State Governments/other Ministries, *etc.* and other miscellaneous items are deducted from the gross expenditure to arrive at the net expenditure on Defence Services for the six Demands, *viz.* Demands Nos. 23 to 28. A brief analysis of these grants is given below except Grant No. 24, Defence Services-Navy and Grant No.25, Defence Services-Air Force which are commented upon in separate reports.

1.5.2 Grant No.21 & 22- Expenditure from Civil Grants

1.5.2.1 Grant No. 21- Expenditure of Ministry of Defence (Civil)

The Budgetary Provision and actual expenditure including Revenue and Capital for the FY 2015-16 under Demand No. 21 is shown in **Table-1** below:

Table -1: Budgetary allocation and actual expenditure: MoD (Civil)

(₹ in crore)		
BE	RE	Actual Expenditure
23877	23190	23324

This included expenditure of ₹19,606 crore under Revenue heads and ₹3,718 crore under Capital head. Major components of these expenditures are shown in the **Table-2**:

Table -2: Table showing major components of Revenue and Capital expenditure

Revenue Expenditure		Capital Expenditure	
Name of Department	₹ in crore	Name of Department	₹ in crore
Canteen Stores Departments (CSD)	14213	Customs-CGO	1517
Defence Accounts Department (DAD)	1166	DEO-Other Building	18
Defence Accounts Department (DAD)- Office/Residential Building	31	DAD-Other Building	6
Department of Defence	121	DAD- Residential Building	9
Coast Guard Organisation (CGO)	1517	Border Roads Organisation	2166
Jammu & Kashmir Light Infantry (JAK LI)	988		
Defence Estate Organisation (DEO)	346		
Border Roads Organisation	1172		
Other Departments	52	Other Departments	2
Total	19606		3718

¹ Report No.20 of Standing Committee on Defence (2012-13, Fifteenth Lok Sabha)

1.5.2.2 Grant No. 22 - Defence Pensions

Defence Pensions, under Ministry of Defence, provides for pensionary charges in respect of retired Defence personnel (including Defence Civilian employees) of the three services, viz. Army, Navy and Air Force, and of employees of Ordnance Factories, etc. It covers payments of service pension, gratuity, family pension, disability pension, commuted value of pension, leave encashment, etc.

The position of budgetary allocation and expenditure for the year 2015-16 under this Grant is as under:

Table- 3: Budgetary allocation and Actual Expenditure*(₹in crore)*

Budget Estimates	Revised Estimates	Actual Expenditure
54,500	60,238	60,238

The persistent excess expenditure under this demand for Defence Pension Grant has always been a cause of concern for audit. However, during the financial year 2014-15 the excess of nearly ₹ 9435.90 crore was incurred after closer of financial year i.e. in November 2015. The appropriation accounts were revised on the ground that the pension payment scrolls lying under Suspense Head which had been booked in the financial year 2015-16 were to be adjusted in the accounts of financial year 2014-15 itself. The erroneous estimation of budget preparation of this grant was commented under Para 4.14 of C&AG's Financial Audit Report No. 50 of 2015. Further, the expenditure booked under PSB Suspense not shown as actual expenditure has been reimbursed by the RBI to the Banks on behalf of MoD.

1.6 Grant No. 23 to 28 – Defence Services Estimates**1.6.1 At a glance**

The overall Defence Budget (Grant No. 23 to 28) allocation and actual expenditure (Voted & Charged) for the period 2011-12 to 2015-16 are given in Table-4.

Table-4: Total Defence Budget allocation and Actual expenditure*(₹in crore)*

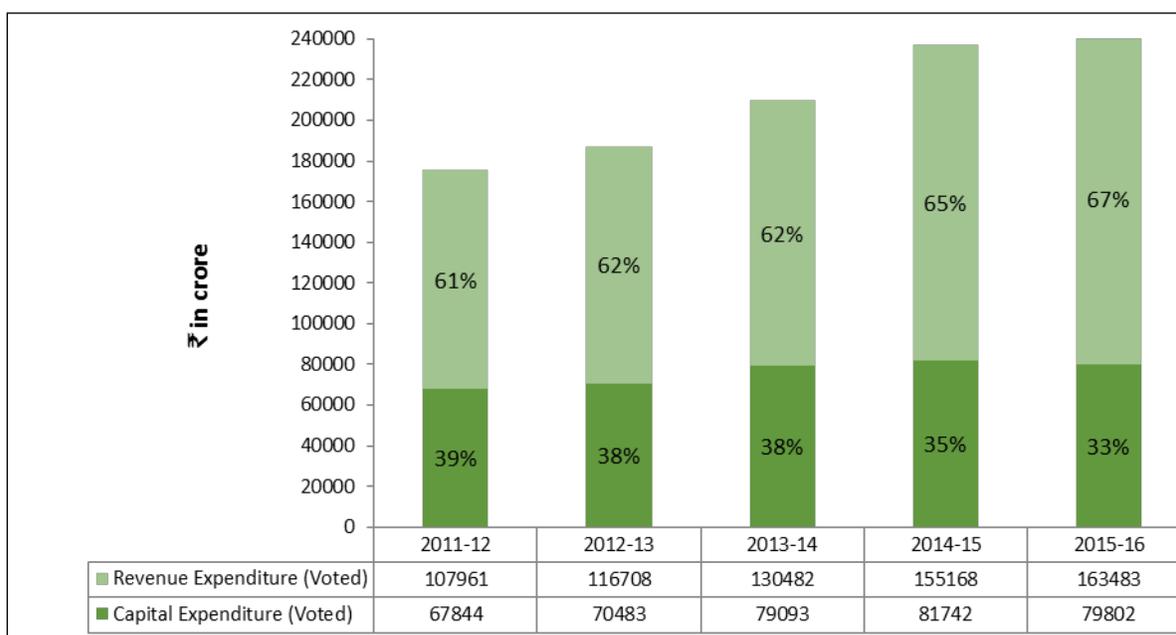
Year	Budget Provision	Actual Expenditure
2011-12	1,78,891	1,75,898
2012-13	1,98,526	1,87,469
2013-14	2,17,649	2,09,789
2014-15	2,54,000	2,37,394
2015-16	2,64,142	2,43,534

The data relating to actual Defence expenditure in 2015-16 shows an increase in expenditure by 2.59 per cent over the previous year and overall increase of 38.45 per cent since 2011-12.

1.6.2 Revenue expenditure vs. Capital expenditure in Defence Services

Capital and Revenue expenditure (voted) for the period 2011-12 to 2015-16 is given in **Chart - 1** below:

Chart - 1: Revenue expenditure vs. Capital expenditure (Voted)



The above data shows that the proportion of Voted Capital and Revenue expenditure as a percentage of total Defence expenditure (voted) has remained between 33 and 39 per cent during the period 2011-12 to 2015-16. However, there was an increase of two per cent in revenue expenditure over the previous year in 2015-16, whereas Capital Expenditure decreased by two per cent.

1.7 Break-up of Expenditure (voted) relating to Army, Ordnance Factories & R&D (Capital & Revenue) – Grant No. 23, 26, 27 and 28²

A detailed analysis of the expenditure (voted) for the period 2011-12 to 2015-16 relating to Army, Ordnance Factories and R & D showing Revenue and Capital expenditure is given in **Table-5** below.

² Grant No. 24 – Navy and Grant No. 25 – Air Force are analysed in the respective Audit Reports of the Union Government (Defence Services) Air Force and Navy

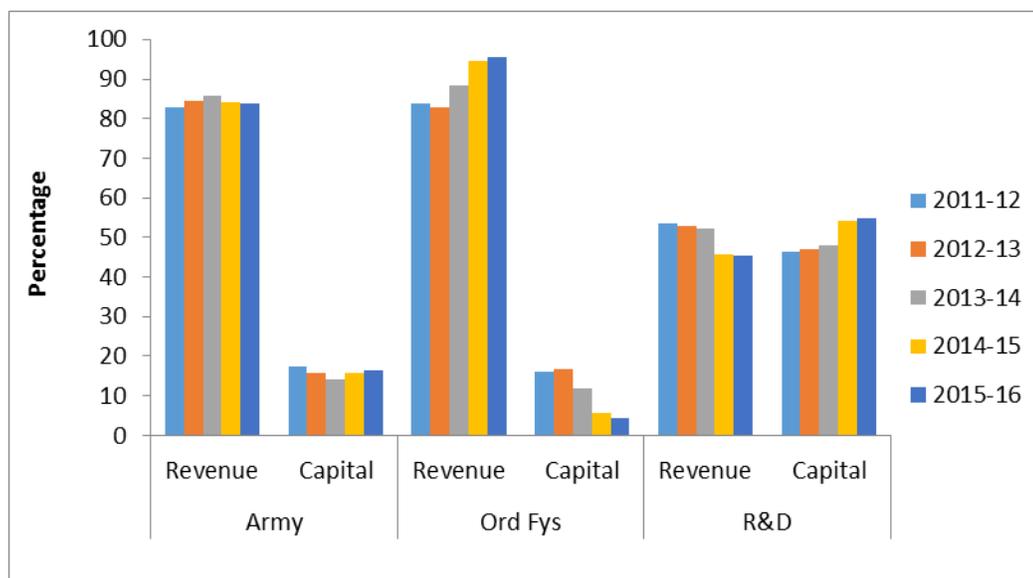
Table-5: Expenditure (voted) of Army, Ordnance Factories & R&D*(₹ in crore)*

Description of Grant	Components of Expenditure	Year				
		2011-12	2012-13	2013-14	2014-15	2015-16
Army	Actual	86,776	94,274	1,02,139	1,17,700	1,26,686
	Revenue	71,833 (82.78)	79,517 (84.35)	87,720 (85.88)	99,139 (84.23)	1,06,021 (83.69)
	Capital	14,943 (17.22)	14,757 (15.65)	14,419 (14.12)	18,561 (15.77)	20,665 (16.31)
Ordnance Factory	Actual	1,704	2,103	3,964	13,576	14,779
	Revenue	1,428 (83.79)	1,754 (82.88)	3,499 (88.26)	12,830 (94.50)	14,120 (95.54)
	Capital	276 (16.21)	349 (16.60)	465 (11.74)	746 (5.50)	659 (4.46)
R&D	Actual	9,932	9,860	10,929	13,635	13,646
	Revenue	5,321 (53.58)	5,218 (52.92)	5,696 (52.12)	6,236 (45.74)	6,183 (45.31)
	Capital	4,611 (46.43)	4,642 (47.08)	5,233 (47.88)	7,399 (54.26)	7,463 (54.69)

Note: Figure in the brackets represents the Revenue/Capital expenditure as a percentage of the total Actual expenditure

- The total Army expenditure during 2015-16 has registered an increase of 7.63 *per cent* over the previous year with the Revenue expenditure registering an increase of 6.94 *per cent* and the Capital expenditure recording an increase of 11.34 *per cent*. Since 2011-12, the components of expenditure have increased by 45.99 *per cent*, 47.59 *per cent* and 38.29 *per cent* respectively.
- The total Ordnance Factory (OF) expenditure has registered an increase of 8.86 *per cent* over the previous year with the Revenue expenditure registering an increase of 10.05 *per cent* and the Capital expenditure recording a decrease of 11.66 *per cent*. Since 2011-12, the components of expenditure have increased by 767.31 *per cent*, 888.80 *per cent* and 138.77 *per cent* respectively, mainly due to change in the process of obtaining of budget provision from Parliament from earlier 'Net basis' to 'Gross basis' w.e.f. 2014-15.
- The total R&D expenditure during 2015-16, has recorded an increase of 0.08 *per cent* over the previous year with Revenue expenditure decreasing by 0.85 *per cent* and the Capital expenditure registering an increase of 0.86 *per cent*. Since 2011-12, the components of expenditure have increased by 37.39 *per cent*, 16.20 *per cent* and 61.85 *per cent* respectively.
- Trend of Revenue and Capital Expenditure as a percentage of the total expenditure at a glance is depicted in Chart-2.

Chart-2: Trend of Revenue and Capital Expenditure as a percentage of the total expenditure



1.8 Trend of major components of Revenue expenditure (Voted)

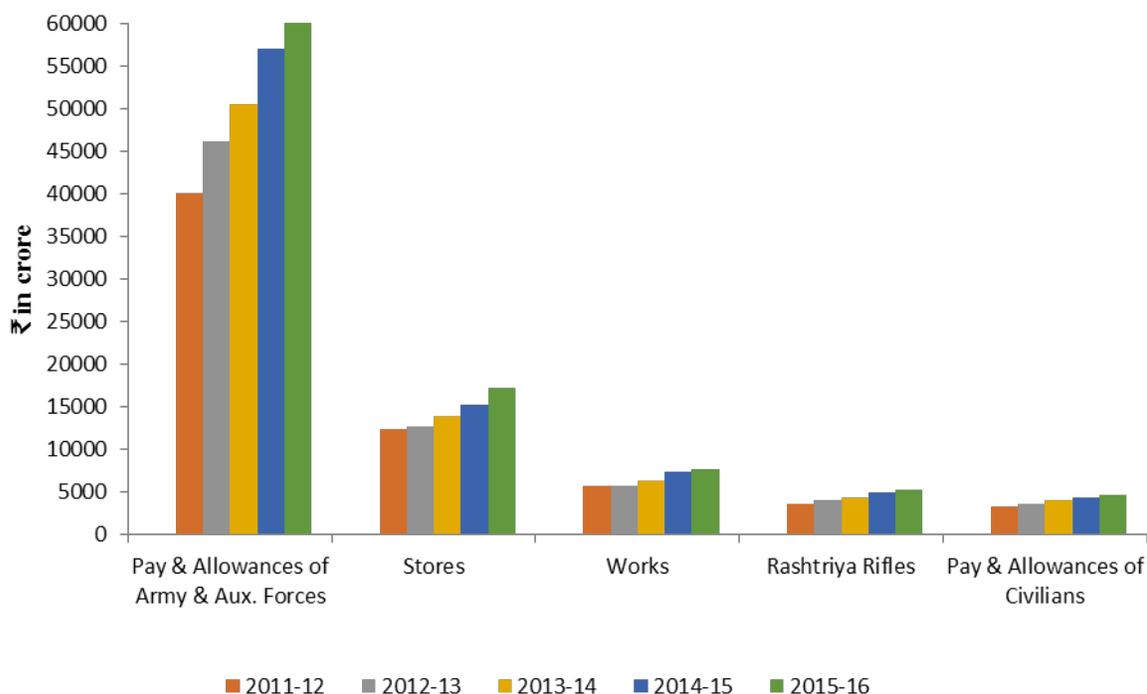
1.8.1 Army (Voted)

During the period 2011-12 to 2015-16 maximum Revenue expenditure was incurred under five Minor Heads (MH) of the Army as given in **Table-6** and in the **Chart-3** below:

Table-6: Details of major components of Revenue expenditure of Army

(₹ in crore)

Components of Expenditure	Year				
	2011-12	2012-13	2013-14	2014-15	2015-16
Pay & Allowances (MH-101& 103)	39,996	46,057	50,533	56,997	60,687
Stores (MH-110)	12,442	12,750	13,954	15,324	17,166
Works (MH-111)	5,709	5,769	6,384	7,399	7,658
Rashtriya Rifles (MH-112)	3,585	4,076	4,436	4,967	5,239
Pay & allow. of Civilians (MH-104)	3,361	3,674	4,056	4,422	4,640

Chart-3: Major components of Revenue expenditure of Army

- Against a seven *per cent* annual increase in the revenue expenditure of Army in 2015-16, overall increase in five Minor Heads ranged between three and 12 *per cent*.

1.8.2 Ordnance Factories (voted)

During the period 2011-12 to 2015-16 maximum Revenue expenditure incurred under five MH of the Ordnance Factories are shown in **Table-7** and in the **Chart-4** below:

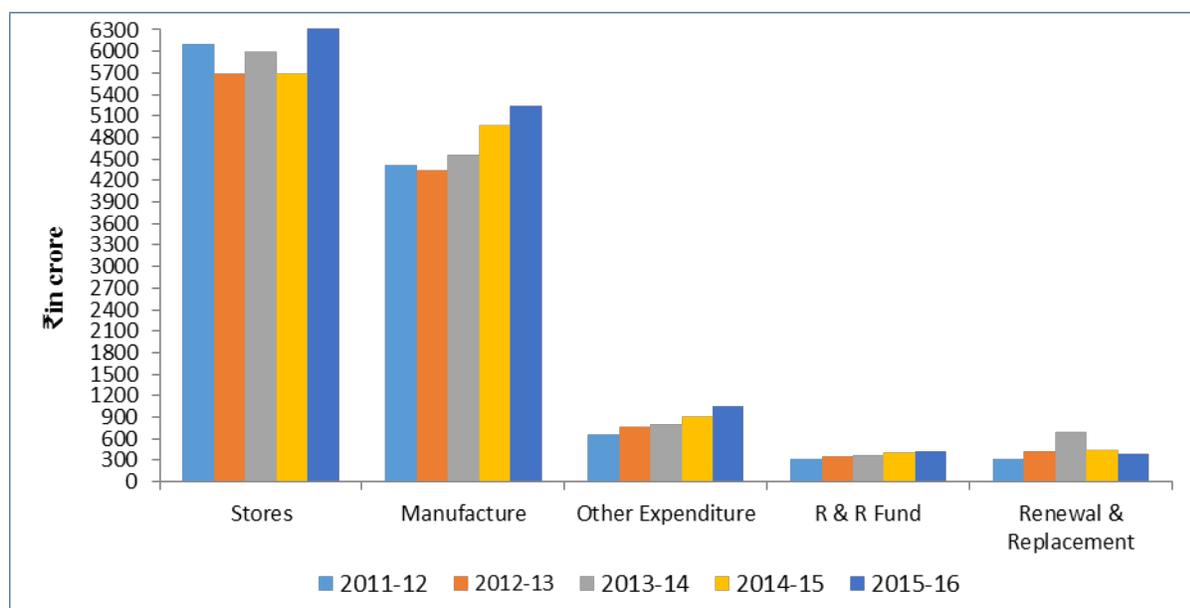
Table-7: Major components of Revenue expenditure of Ordnance Factories

(₹ in crore)

Components of Expenditure	Year				
	2011-12	2012-13	2013-14	2014-15	2015-16
Stores MH-110	6,101	5,692	5,990	5,686	6,522
Manufacture- MH-054	4,415	4,336	4,563	4,961	5,234
Renewal & Reserve (R&R) Fund MH-797	325	350	375	400	425
Renewal & Replacement MH-106	310	416	697	442	386
Other expenditure MH-800	650	768	795	911	1055

- Against a 10 percent annual increase in the revenue expenditure of Ordnance Factories in 2015-16, overall increase in four Minor Heads having highest expenditure viz. Stores, Manufacture, Renewal & Reserve (R&R) Fund and Other Expenditure ranged between five and 16 percent. However, there is decrease in one Minor Head – Renewal & Replacement by 13 per cent over the previous year.

Chart 4: Major components of Revenue expenditure of Ordnance Factories



1.8.3 Research & Development (voted)

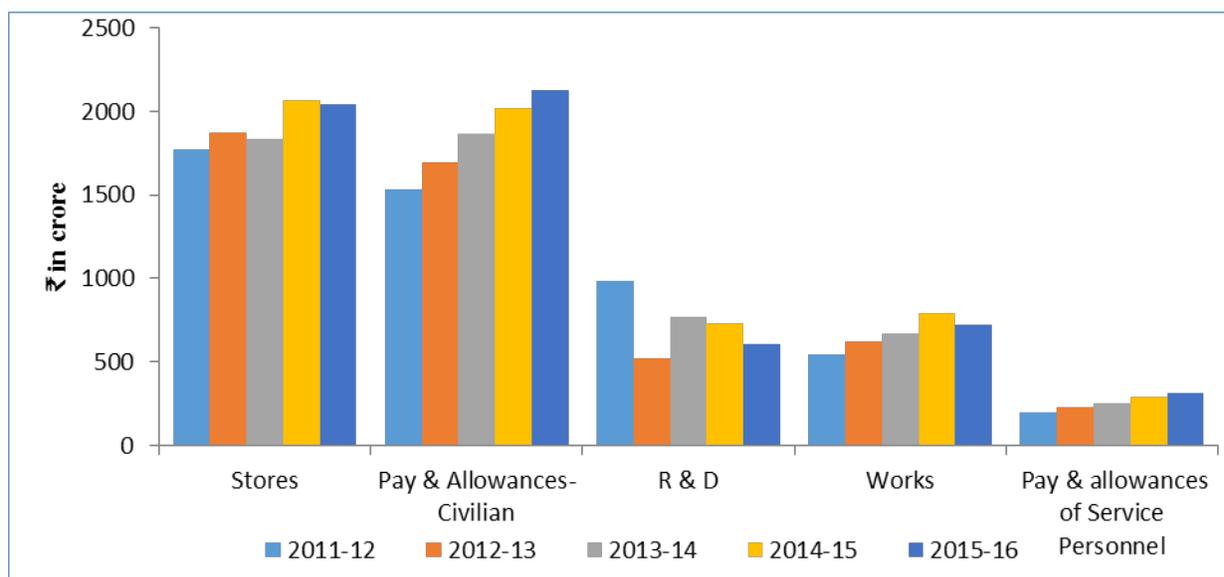
During the period 2011-12 to 2015-16 maximum Revenue expenditure incurred under five Minor Heads (MH) of the R&D are given in **Table-8** and **Chart-5** below:

Table-8: Major components of Revenue expenditure of Research & Development

(₹ in crore)

Components of Expenditure	Year				
	2011-12	2012-13	2013-14	2014-15	2015-16
Stores MH-110	1,774	1,870	1,837	2,063	2,041
Pay & Allowances- Civilian MH-102	1,535	1,694	1,865	2,021	2,129
R&D MH-004	984	517	765	733	605
Works MH-111	543	621	669	790	721
Pay & Allowances of Service Personnel MH-101	198	226	251	285	309

Chart 5: Major components of Revenue expenditure of Research & Development



- Against a 8.5 percent annual increase in the revenue expenditure of Research & Development in 2015-16, overall increase in two Minor Heads having highest expenditure viz. Pay & Allowances-Civilian and Pay & Allowances of Service Personnel ranged between five and eight percent. However, there were decreases in three Minor Head – Stores, R&D and Works which ranged between one and 17 per cent over the previous year.

1.9 Trend of Capital expenditure - Major Head-4076-Grant No. 28-Capital Outlay on Defence Services

1.9.1 Components of Capital expenditure

There are eight Sub Major Heads (SMH) under this Grant, viz. Sub Major Head 01- Army, Sub Major Head 02 - Navy, Sub Major Head 03- Air Force, Sub Major Head 04- Ordnance Factories, Sub Major Head 05 - R&D, Sub Major Head 06 - Inspection Organisation, Sub Major Head 07 - Special Metal and Super Alloys Projects and Sub Major Head 08- Technology Development.

1.9.2 Trend analysis of Capital expenditure³ (voted) of Army, Ordnance Factories and R&D

The details of Capital expenditure of Army, Ordnance Factories and R&D during the period 2011-12 to 2015-16 are given in **Table-9** below:

³ SMH-02 and SMH-03 are analysed separately in the respective Audit Reports of Union Government (Defence Services) of Navy and Air Force. In respect of SMH-06 and SMH-08 total expenditure for the period 2011-12 to 2015-16 was ₹40 crore and ₹58 crore respectively. In respect of SMH-07 the expenditure during these years was Nil.

Table-9: Total Capital Expenditure (Defence Services) Vs Army, Ordnance Factories and R&D*(₹in crore)*

Capital Expenditure	Year				
	2011-12	2012-13	2013-14	2014-15	2015-16
Defence Services	67,844	70,483	79,093	81,742	79,802
Army	14,943	14,757	14,419	18,561	20,665
Ordnance Factories	276	349	465	746	659
Research & Development	4,611	4,642	5,233	7,399	7,463

- **Capital Expenditure of Defence Services:** Capital expenditure of Defence Services has recorded decrease of 2.37 *per cent* in 2015-16 over the previous year. In case of Army and R&D the annual increase was however, 11 and 0.86 *per cent* respectively. Ordnance Factories has recorded decrease of 12 *per cent*.
- For the period from 2011-12 to 2015-16 against the overall increase 18 *per cent* in the Capital Expenditure of Defence Services, the increase in expenditure under Army, OF and R&D was 38, 139 and 62 *per cent* respectively.

1.9.3 Trend of Saving/Excess in Capital expenditure (voted)

The trend of 'Saving' and 'Excess' in Capital Expenditure for the period 2011-12 to 2015-16 is given in **Table-10** below:

Table-10: Trend of Saving/Excess in Capital Expenditure

Year	Total Grant (Voted)	Total Expenditure	Under Total Capital Grant	
			Saving(-)	Excess (+)
2011-12	69,148.01	67,843.96	1,304.05 (1.89%)	-
2012-13	79,526.99	70,483.32	9,043.67 (11.37%)	-
2013-14	86,685.31	79,092.91	7,592.40 (8.76%)	-
2014-15	94,257.01	81,741.90	12,515.11 (13.28%)	-
2015-16	94,451.52	79,801.95	14,649.57 (15.51%)	-

Note: Figure in brackets represents the saving (-)/excess (+) as a percentage of Total Grant (Voted).

- It is evident from the above Table that during 2011-12 to 2015-16 there were persistent 'Savings' from 1.89 *per cent* to 15.51 *per cent*.
- Increase in 'Savings' was noticed from ₹ 12515.11 crore (13.28 *per cent*) during 2014-15 to ₹ 14649.57 crore (15.51 *per cent*) in the year 2015-16. However, funds amounting to ₹ 15122.13 crore (16 *per cent*) were surrendered on the last working day of the financial year 2015-16 which was more than savings.

1.10 Recoveries/Savings and adjustment in accounts at the instance of Audit

Based on audit observations, the audited entities⁴ had recovered ₹ 4.86 crore on account of overpaid pay and allowances, sundry charges, training charges, LTC claims, rent & allied charges, electricity charges, cancelled irregular works sanctions of ₹ 5.08 crore and amended annual accounts to the extent of ₹ 48.70 crore having a net effect of ₹58.64 crore as per **Annexure-I, II and III**.

1.11 Response of the Ministry/Department to Draft Audit Paragraphs

On the recommendations of the Public Accounts Committee, Ministry of Finance (Department of Expenditure) issued directions to all Ministries in June 1960 to send their response to the Draft Audit Paragraphs proposed for inclusion in the Report of the Comptroller and Auditor General of India within six weeks.

The Draft Paragraphs are forwarded to the Secretaries of the Ministry/ departments concerned drawing their attention to the audit findings and requesting them to send their response within six weeks. It is brought to their personal attention that in view of likely inclusion of such Paragraphs in the Audit Reports of the Comptroller and Auditor General of India, which are placed before Parliament, it would be desirable to include their comments in the matter.

Draft paragraphs proposed for inclusion in this Report were forwarded to the Secretaries concerned between August 2016 and February 2017 through letters addressed to them personally.

The Ministry of Defence did not send replies (January/February 2017) to 20 paragraphs out of 28 Paragraphs featured in Chapters II to VII.

⁴ Except Ordnance Factories cases of which are discussed in Para 7.1.4

1.12 Action taken on earlier Audit Paragraphs

With a view to enforcing accountability of the Executive in respect of all issues dealt with in various Audit Reports, the Public Accounts Committee desired that Action Taken Notes (ATNs) on all paragraphs pertaining to the Audit Reports for the year ended 31 March 1996 onwards be submitted to them duly vetted by Audit within four months from the date of laying of the Reports in Parliament.

Review of ATNs relating to the Army as of January 2017 indicated that ATNs on 73 paragraphs included in the Audit Reports up to the year ended March 2015 remained outstanding, of which the Ministry had not submitted even the initial ATNs in respect of 26 Paragraphs and 11 ATNs (Sl. No.1 to 11) are outstanding for more than 10 years as shown in **Annexure-IV**.