

**Before the**  
**MAHARASHTRA ELECTRICITY REGULATORY COMMISSION**  
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**Case No. 32 of 2001**

**In the matter of**  
**Application filed by Pune Chapter of Cost Accountants in respect of conducting**  
**Cost Audit by Cost & Management Accountants in Generating**  
**Stations, etc. of the Maharashtra State Electricity Board.**

**Dr Pramod Deo, Chairman,**  
**Shri A. Velayutham, Member**

**ORDER**

**Dated: 12<sup>th</sup> September, 2005**

Under their Petition dated 13<sup>th</sup> March, 2002, the Pune Chapter of Cost Accountants of the Institute of Cost & Works Accountant of India (ICWAI), through Shri Nishikant N. Kale and Shri Shiram M. Sane, have prayed inter alia, for directions and action in respect of the Maharashtra State Electricity Board (MSEB) as follows:

- (1) Conducting Cost Audit & certification of internal auditors statements of the MSEB, for establishing the validity and accuracy of various data and calculations, including for all future tariff and other proposals.
- (2) Action under Sections 44 & 45 of the Electricity Regulatory Commissions (ERC) Act, 1998 for not appointing Cost Auditors for conducting the Cost Audit from 1<sup>st</sup> April to 30<sup>th</sup> September 2001, in the context of the Commission's FOCA and other Orders
- (3) Not to submit any proposal for tariff increase unless a Cost & Management Committee is appointed and Cost & Management Audit is commenced.
- (4) To direct the Govt. of Maharashtra (GoM) to constitute the Board of the MSEB as suggested in para 13 of the Petition considering the need for costing and auditing and to make GoM a party to these proceedings accordingly.

2. The Commission, after hearing the parties, passed an Interim Order dated 7<sup>th</sup> May 2002 directing MSEB inter alia, to *"submit a scheme, depicting the methodology and approach, for the implementation of Cost Accounting and Management Audit in its various Generating Stations and Distribution Circles taking into consideration the valuable suggestions made by the Petitioner..."*



3. In compliance of the Interim Order, MSEB submitted a Pilot Scheme on Cost Audit vide letter dated 6<sup>th</sup> June 2002, stating also that the Institute of Cost & Works Accounts of India (ICWAI), Western India Regional Council (WIRC) Mumbai has been engaged on 31<sup>st</sup> May, 2002 to undertake the study of existing accounting and costing records of MSEB and devising a system to facilitate compliance with the Cost Accounting Records (Electricity Industries) Rules, 2001.

4. Shri Kale has contested validity of the Pilot Scheme vide his submission on 18.6.2002. However, the Commission rejected his stand vide its letter No.627 dated 1.7.2002. He further took up the matter vide his letter dated 8.7.2002 with the Institute of Cost & Works Accountants of India, Kolkata.

5. Subsequently, vide letter dated 31<sup>st</sup> May, 2003, MSEB sought an informal meeting with the Commission for discussing the modalities for implementation of Cost Accounting system and cost audit. However, the Commission decided to hold a further formal hearing, to which all parties to the FOCA Order and the Petitioners were invited.

6. At the hearing held on 18<sup>th</sup> June, 2003, referring to MSEB's compliance letter dated 6.6.2002, Shri Kale pointed out that it was not accompanied by a copy of the Board's Resolution. As far as the modalities for going forward were concerned, MSEB had placed the consultancy order on the Western India Regional Council (WIRC) of the Institute of Costs & Works Accountants (ICWAI). Hence, the scheme placed by MSEB before the Commission should have been signed by an authorized representative of WIRC.

7. Shri Kale submitted that, more importantly, as per the Act of 1951 under which ICWAI functions, the WIRC is not supposed to undertake cost auditing work, its functions under the statute being quite different. Thus, MSEB should have commissioned individual members of ICWAI /WIRC. The latter are not an auditing or consulting firm, and mentioned that he had furnished a copy of WIRC's functions earlier. The Commission's interim directives dated 7<sup>th</sup> May, 2002 in Case No. 32 of 2001 regarding submission of a scheme requires that the methodology should be certified by a practising cost accountant so that he can be held accountable for any error of omission or commission. Shri Kale submitted that, once an initial wrong step is taken, then the rest of the process would be vitiated.

8. Shri Kale pointed out that not a single suggestion made by him has been taken into account by MSEB in spite of specific directions from the Commission. Moreover, only a sample survey was proposed to be conducted, upon which a Member of the Commission had stated that this may not be sufficient. This too has not been taken into account.

9. Shri Kale submitted that, thus, the correct procedure has not been followed in preparing the scheme, making it a futile exercise. He also submitted that MSEB has been adopting different stands from time to time. At first, MSEB had stated that they were working on the basis of a cost-plus formula. Thereafter, they stated that they would proceed on the basis of cost accounting and auditing. If so, MSEB should have withdrawn their case from the High Court with regard to their claim that they can adopt a cost-plus approach. The Commission observed that this was irrelevant in as much as the procedure to be followed by MSEB would be discussed today and, if necessary, the Commission may consider giving them further guidelines on how to proceed. Reiterating his earlier reference to the need for a Board Resolution, Shri Kale submitted that if MSEB would now be following the process of cost accounting and auditing and doing away with the cost-plus approach, then this has to be supported by such a Resolution. The Enron / DPC matter shows the consequences of not following cost accounting / auditing, resulting in the project becoming unaffordable. Moreover, as far as the scheme itself is concerned, distribution circles have not been incorporated.



10. The Commission observed that the first step would be to determine whether the correct methodology is being followed or not. Thereafter, the details of the scheme can be discussed. Shri Kale responded that the interim Order provides that comments be invited from "any other" professional institutes or bodies, and therefore a copy of MSEB's scheme should be circulated to all concerned, such as the Institute of Engineers. The Commission observed that this may be premature. To a query from the Commission, Shri Kale clarified that he was not seeking that the Commission invoke powers under Sections 44 or 45 of the ERC Act. The Commission observed that it had directed MSEB to keep the scheme on their website, and that should be sufficient. For the present, the limited point was whether the procedure / methodology adopted by MSEB is appropriate or not.

11. Shri Kale stated that he would be submitting certain relevant papers which he has brought with him, including material from the Directorate of Costing. He pointed out that the Rules framed by GoI in 2001 in this regard are not applicable to the State Electricity Boards. He also pointed out that, in the circumstances, MSEB cannot even proceed with a tariff proposal without undertaking cost audit. The Commission observed that this is a matter which can be raised during the hearings in those proceedings.

12. Shri Bhamre, former MSEB Engineer and Chairman, Baglan Panchayat Samiti intervened to point out that MSEB were to file a project report for FOCA, which they had not done for the last two years. The Commission observed that the case was decided in July, 2001, and that it was expected that it was expected that, after a certain period, no FOCA would be passed on to consumers without cost audit. This has not been done. In fact, the Commission's orders both with regard to cost audit in respect of FOCA, and to such audit for their entire operations, have yet to be implemented by MSEB. Reiterating his contentions that MSEB's tariff proposal should not be proceeded with in the absence of cost audit, Shri Kale also urged that MSEB be directed to refund FOCA recoveries to consumers. Dr S.L. Patil of Thane Belapur Industries Association (TBIA) stated that details of the methodology should be known, and agreed with Shri Kale's contention regarding the levy of FOCA.

13. On behalf of MSEB, Shri Krishna Rao, Member (Finance), recalled the Commission's FOCA Order dated 31<sup>st</sup> July, 2001 which refers to the submission of cost audit report, and the assignment / appointment of suitable firms for verification. The progress was reviewed thereafter, and a methodology submitted by MSEB on 6<sup>th</sup> June, 2002. WIRC had been asked to undertake this work since MSEB were not able to identify individual cost accountants/ auditors familiar with the power sector. WIRC had stated that they would be able to identify suitable cost accountants, assign them the work, and provide MSEB with a pilot study, which has now been commissioned by MSEB.

14. Shri Dhananjay Joshi, WIRC Chairman and ICWAI Central Council Member stated that ICWAI has been established under an Act of Parliament. It has a Central Council with elected members, and four Regional Councils. The Central Council is the highest decision-making body. Under the law, WIRC is fully entitled to carry out research work of a national or regional importance, and a decision has been taken by the Council on the basis of which WIRC has proceeded. He stated that he would furnish a copy to the Commission. He submitted further that WIRC has conducted several such studies, e.g. the most recent one on woven sacks for a Manufacturers' Association and is now engaged in an assignment for the Tea Board. In fact, this is a normal activity involving applied research. He clarified that what WIRC would be doing is designing a methodology for the accounting and auditing of MSEB.

15. The Commission summarized its understanding of Shri D. Joshi's submission that, in order to undertake cost auditing, a cost accounting system is necessary. Such a system is to be drawn up, for which purpose MSEB have approached WIRC. One of the doubts expressed is that, since there are individual cost accountants available, it is not clear exactly what WIRC would be doing. Shri Joshi clarified that WIRC have put in place a group of experts for designing the cost



accounting system and providing a module. Once MSEB have this system in place, then further steps would follow. He confirmed that cost auditing is a later stage, and requires designing an accounting system. The audit itself would have to be done by a professional individual/ firm thereafter. The Commission observed that the methodology would have to be examined by the public and also that each professional would follow his own method once the accounting systems are set up. The Commission is concerned only with the cost auditing reports, and not the details of how such auditing is conducted. Shri Krishna Rao submitted that once the system is in place, auditors may change from time to time, but each successive auditor cannot simply say that he disagrees entirely with the manner in which his predecessor has conducted the audit.

16 Shri Joshi of WIRC clarified that, for any cost accounting procedure, it can take 3-4 years for cost auditing. The particular industry first has to be surveyed, then Rules are framed (e.g for the power sector) in accordance with which records are to be maintained. Thereafter, GoI issues cost accounting orders after one or two years in respect of that industry. To a query from the Commission, he clarified that the Rules framed for the power sector are applicable only to entities under the Companies Act. However, these can be used as guidelines to some extent for systems to be developed for MSEB, with adjustments.

Shri Krishna Rao submitted that MSEB's accounting systems are different from those under the Companies Act, i.e. they are benchmarked under the I.E. Act 1910. Therefore, the whole system has to be devised afresh in this context.

17. Shri Joshi of WIRC submitted that their work is already at an advanced stage. ICWAI is a national-level professional body with a Central Council and technical Directors. The work assigned by MSEB is a prestigious project for WIRC. For the generation segment, the study is at a final stage, and the distribution segment is underway. Intensive discussions have already been held with 15/20 cost audit experts and other relevant professionals, apart from several interactions with MSEB.

18. The Commission asked whether WIRC are taking into account the requirements of cost as well as management audit, or only cost accounting records and, if the latter, whether such records would be appropriate for management audit. Shri Joshi clarified that the advanced stage of cost accounting constitutes management accounting, i.e. it deals with operational and efficiency aspects. In fact, the basis of any management accounting is cost audit. He stated that the focus is fast changing from cost to management accounting. The first rules were framed by GoI in 1968, and were revised after a long gap in 1996. They were again revised after a short period, i.e. in 2001. New reporting requirements have been added which indicate the emphasis on the management aspects. Operational efficiencies are required to be examined under the new rules (albeit applicable only to Companies), including matters such as how to make the Company profitable and identification of areas where performance improvement is necessary. In these matters, specific remarks have to be given by the auditors. He also mentioned that ICWAI runs a post-graduate course in Management Accountancy.

19. Shri Deodhar, past President of ICWAI submitted that the methodology to be followed in respect of the assignment to WIRC should be kept outside the purview of the present proceedings, pointing out that the Petitioner in this case (Shri Kale) is also before the ICWAI/WIRC under the Act as a disputant. The present Rules of 2001 framed by GoI are only applicable to Companies, and GoI have not thought it fit to extend them to the SEBs. Reiterating Shri Joshi's submission, Shri Deodhar stated that MSEB had asked WIRC to suggest the systems. WIRC is fully competent to do so, and would not be doing the actual auditing. The concerned organisation has to gear up for cost audit within 2/3 years of the system being prescribed. As far as WIRC are concerned, they have a one to one contract with MSEB.



20. Shri Krishna Rao reiterated that the assignment has been initiated following the Orders of MERC, and that the reports would be shared with the Commission. ICWAI are a professional body, which would be consulting experts in the relevant fields. If the matter is thrown open to the public at this stage, then there will be no end to the process and it would only delay the cost audit itself.

21. To a query from the Commission regarding the time frame, considering the fact that the study has not been completed even after a year after submission of MSEB's letter dated 6<sup>th</sup> June, 2002, Shri Joshi of WIRC reiterated that the final report on generation was almost ready, and it was expected that the report on distribution would be completed by the end of July 2003. The Commission pointed out that MSEB were first given directives as long back as July 2001. It was led to believe that the system would be in place by August 2002, and regretted that this has not been happened. Shri Krishna Rao clarified that when MSEB made the commitment originally, they sincerely believed that it would be completed in that time frame. However, each segment has several parts, e.g. thermal, hydro, and gas in respect of generation, and one station for each of these has been taken up for study simultaneously. The assignment was discussed internally and recently awarded to WIRC.

22. Shri Ramesh Joshi, Honorary Secretary, ICWAI drew attention to the fact that cost audit / accounting was known in other parts of the world as management auditing / accounting, even in Pakistan and other neighbouring countries, but not so far in India where the Act had yet to be suitably revised. Emphasis of cost audit in the present context is to help management to improve performance, and the cost auditor has to be specific in his recommendations on these matters. Since circumstances change every year, this is a dynamic process, and successive auditors may, therefore, have different perspectives. Financial accounting only takes care of money records, whereas cost accounting is something more than that, and includes operational areas. Financial records form a small component and basis for it.

23. The Commission observed that, given the time frame, the issue was the manner in which trust in MSEB's accounts can be improved in the intervening period. Shri Krishna Rao responded that, in its FOCA Order, the Commission had asked that professional services be engaged. The present accounts are being prepared by internal auditors and verified and clarified by professional CAs in respect of FOCA, gas and coal, and certified accordingly. The Commission observed that the matter of improvement of operational performance, e.g. with regard to break-down of transformers, etc., would have to be brought within this ambit.

24. Shri Joshi of WIRC pointed out that Shri Kale had represented his points to ICWAI/ WIRC and also to the Department of Company Affairs, GoI that WIRC should not take up this assignment. His letter was discussed by the Central Council of ICWAI, and the Council decided that the undertaking of this work by WIRC was acceptable and within the framework of law. Shri Joshi submitted that the proper forum for challenging this is the Institute itself and the framework of the Act under which it has been established. Shri Kale responded that ICWAI cannot go beyond its law and regulations to approve something which is outside its ambit. The Commission observed that MERC is not the appropriate forum to adjudicate on the powers of ICWAI or WIRC under their statute.

25. Shri Kale submitted that the issue concerns the implementation of a system to control and monitor critical aspects of MSEB. He contended that he himself and Shri Sane can devise the system quickly and provide reports every six months. WIRC are not competent and are unfamiliar with the requirements whereas he along with Shri Sane, have been working with MERC in this matter for the last four years.



26. To a query from the Commission, Shri Joshi of WIRC stated that the 2001 Rules for the power sector had been finalized by the Cost Audit Branch of the Dept of Company Affairs, headed by an Advisor, in consultation with ICWAI. WIRC has taken those Rules into consideration wherever there is commonality. The Commission mentioned that the Bureau of Industrial Costs and Prices (BICP) had written to MERC and others offering various consultancy services. The MSEB representatives stated that they were not aware of this at the time. Shri Joshi of WIRC submitted that, in any case, the system would be ready within three months, whereas BICP would have to examine and study the whole matter from the beginning. Physical inspection also has to be undertaken to understand the set up. He pointed out that, moreover, ICWAI members are also in BICP.

27. To the Commission's observation that the study may be useful from management's point of view, but whether the system would also meet the requirements of the consumers, Shri Joshi responded that the sequence is that, first the system has to be devised. Thereafter, records have to be prepared and maintained in accordance with that framework, and professional auditors appointed to analyze these records. The independence and professional standing of such auditors would determine the confidence level of the consumer. It is for this purpose that the structure and the systems are being created. Shri Sanjay Bhargava, WIRC Member stated that the system is being designed by WIRC after detailed micro-level examination. This would enable cost cutting and improvement in efficiency, and thereby work in the consumer's interest.

28. To a query from the Commission regarding the time it would take for a meaningful audit, MSEB representative stated that the pilot study for Nashik, Koyna and Uran is nearly ready, and MSEB would implement it in these three stations within three months. Thereafter, it would be extended to other generating stations. Thus, by the end of 2003-04 it would be possible to cover the whole State as far as generation is concerned. Shri Joshi of WIRC stated that the study regarding cost accounting system for both transmission and distribution can be completed in three months. However, this is subject to the transmission scheme also being awarded to them. As far as transmission is concerned, Shri Krishna Rao stated that he would separately submit to the Commission the implementation time frame.

29. The Record of Proceedings of the hearing were circulated to all concerned. Thereafter, under affidavit dated 25<sup>th</sup> May, 2004, MSEB submitted that:

- The Report submitted by WIRC-ICWAI in respect of three pilot generating stations (Nashik-Thermal Power, Uran-Gas Turbine power and Pophali-Hydro power) have been accepted by MSEB and forwarded to the respective power stations in December 2003 for implementation.
- Accordingly, they have started preparation of cost accounting reports, which will be submitted to the Lead Auditor by June, 2004. The audit report for the period from April to September 2003 will be submitted to the Commission in August 2004.
- The cost accounting reports in respect of distribution Circles (Bhandup, Dhule and Solapur) submitted by WIRC-ICWAI has been accepted by MSEB in April, 2004.
- The assignment with regard to transmission scheme is yet to be awarded to WIRC-ICWAI, which will be done after successful completion of cost accounting in respect of distribution scheme.

30. In the light of the above submissions, the Commission invited MSEB to make a presentation to it and discuss the following matters:

- (a) Keeping in view the basic objective behind the Commission's directions on Cost Audit and Cost Accounting Systems, the developments so far, including a brief on the pilot schemes and their implementation status.



- (b) Selection of key operational parameters for immediate focus, for which benchmarks already exist or can be easily developed and data is available and can be organized to enable quick monitoring, corrective and verification action across its entire operations, pending the completion of the more comprehensive exercise in due course.

31. At the meeting with MSEB on 5<sup>th</sup> July, 2004, the Commission observed the following:

A. **Distribution:**

- The Institute of Cost & Works Accountants of India Western India Regional Council (WIRC-ICWAI), who were engaged by MSEB, have submitted final report for a scheme of cost accounting in respect of three pilot distribution circles, viz. Bhandup, Dhule and Solapur, which has been approved by MSEB in April, 2004.
- Training of staff in these three distribution circles with regard to preparation of records, etc., will be completed in July, 2004.
- Records as per the pilot scheme will be prepared for each of these circles for the period April to September 2004 by December, 2004, along with previous year's data.
- External cost auditor will be appointed by MSEB in December, 2004 for preparation of cost audit reports for the above period, by February, 2005.
- The performance norms selected for monitoring, review and corrective action as per the scheme, and the achievements against these norms should be submitted to the Commission.

B. **Generation: Generation and operational performance to match with CEA definition and is available for each plant and each unit.**

- The pilot cost accounting scheme prepared by WIRC-ICWAI has been approved in respect of three generating stations viz. Nashik (thermal) Uran (gas) and Pophali (hydro).
- Training to the staff at these generating stations was completed in September 2003.
- Records have been prepared according to the pilot scheme for the period April – September, 2003.
- External cost audit reports would be completed by August, 2004 and submitted to the Commission.
- The cost accounting scheme will be extended to all remaining generating stations from December 2004.

32. The Commission also noted that the receipt of Circle-wise energy accounting data and Merit Order Despatch data from MSEB has been erratic. The submissions should be brought up-to-date and furnished to the Commission by 1<sup>st</sup> August, 2004, and regularly thereafter.

33. As regards external cost audit reports in respect of the three pilot Generating Stations (Nashik Thermal Station, Uran Gas Station and Pophali Hydro Power Station), MSEB have, under letter No. TRC/CAR/25705 dated 27<sup>th</sup> August, 2004 and subsequent letters, have submitted the following cost audit reports for the above three pilot schemes.

- (1) External Cost Audit Report for three Pilot Generating Stations viz. Nashik Thermal Power Station, Uran Gas Thermal Power Station & Phophali Power Station for the period April 2003 to September 2003 vide MSEB's letter dated 27<sup>th</sup> August, 2004.
- (2) Cost Audit Report for Generating Station, Nasik for the period September 2003 to March 2004 vide MSEB's letter dated 4<sup>th</sup> March, 2005.



- (3) Cost Audit Report for Pilot Generating Station, Parali for the period 2003 -04 vide MSEB's letter dated 15<sup>th</sup> March, 2005.
- (4) Cost Audit Report for Generating stations at Bhusawal & Khaperkheda for the year 2003-04 vide MSEB's letter dated 19<sup>th</sup> April, 2005.
- (5) Cost Audit Report for Koyna Generating Station Complex, Phophali for the period October 2003 to March 2004 vide MSEB's letter dated 2<sup>nd</sup> May, 2005.
- (6) Cost Audit Report for three pilot distribution circles (Bhandup Urban Circle, Dhule O&M Circle and Solapur O&M Circle) for the period April 2004 to September 2004.
- (7) Cost Audit Report for Thermal Power Station, Paras for the period 2003 - 04 vide MSEB's letter dated 6<sup>th</sup> May, 2005.
- (8) Cost Audit Report for Generating Stations, Koradi & Chandrapur for the period 2003 - 04 vide MSEB's letter dated 27<sup>th</sup> May, 2005.

Copies of the above Reports were sent to Shri N.N. Kale and Shri S. M. Sane (Petitioners) for comments / inputs, if any. Shri Kale has furnished his comments on 17<sup>th</sup> March, 2005, 6<sup>th</sup> April, 2005 and 8<sup>th</sup> April, 2005 and Shri Sane has submitted his comments on 8<sup>th</sup> April 2005.

34. While finally disposing of this Petition, the Commission notes that it has to be concerned more with outputs and end results rather than the internal processes by which these are achieved by MSEB. The Commission cannot ascribe to itself the executive and administrative functions of MSEB or the State Govt., nor would it be appropriate to attempt micro management. However, the adoption of an appropriate methodology and implementation of cost accounting and auditing is an important tool for efficiency improvement and cost reduction, and also for enabling informed assessments by regulators and stakeholders. The Commission acknowledges the role played by the Petitioners in focusing attention on these issues and to move MSEB in this direction in a more systematic manner.

35. During these proceedings, the Petitioners have challenged the validity of the engagement by MSEB of ICWAI (WIRC) to formulate the costing and auditing schemes. However, it is outside the competence and jurisdiction of the Commission to decide on that matter, for which there is a separate legal framework with which other authorities may be concerned.

36. The Commission also notes that another important development has taken place recently, viz. the unbundling of MSEB into three companies (comprising a holding company, and three companies for the generation, transmission and distribution functions). As such, it appears that the functional successor entities would now be subject to the provisions of the Cost Accounting Records (Electricity Industry) Rules, 2001 and all other dispensations applicable in this regard to all other such companies, which was not the case earlier. As such, the process set in motion through this Petition would have to be pursued by the erstwhile MSEB accordingly. While doing so and refining their methodologies, these successor entities may take into consideration the comments and inputs provided by the Petitioners on the Cost Audit reports submitted so far.

Sd/-  
(A. Velayutham)  
Member

Sd/-  
(Dr Pramod Deo)  
Chairman, MERC



(A.M. Khan)  
Secretary, MERC