Reliance Energy Limited & Another vs Maharashtra State Road Development ... on 11 September, 2007

Bench: Arijit Pasayat, S. H. Kapadia

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           CASE NO.:
Appeal (civil)  3526 of 2007

PETITIONER:
Reliance Energy Limited & Another

RESPONDENT:
Maharashtra State Road Development Corporation Ltd. & Others

DATE OF JUDGMENT: 11/09/2007

BENCH:
DR. ARIJIT PASAYAT & S. H. KAPADIA

JUDGMENT:
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J U D G M E N T CIVIL APPEAL NO.3526 OF 2007 KAPADIA, J.

1. State of Maharashtra through Maharashtra State Road Development Corporation Ltd. (for short, "MSRDC") floated Global Tender for completing Mumbai Trans Harbour Link ("MTHL") between Mumbai and Navi Mumbai on BOT basis.

2. Reliance Energy Limited is a company registered under the Companies Act, 1956. It is engaged in generation, transmission and disbursement of power in Maharashtra, Delhi etc.

3. Hyundai Engineering and Construction Company Ltd. (for short, "HDEC") is a company incorporated in Korea. It is specialized in construction of bridges.

4. At this stage, it may be noted that the above Project is to be at the cost of Rs. 26000 million (Rs. 2600 crores). The bidders were required to submit RFQ Document by 10.1.2005. Under the PQ Document, M/s Jean Muller, France was appointed as consultant by MSRDC. Under the PQ Document, the bidders were required to submit financial statements of three financial years subject to the condition that the latest should not be earlier than the financial year ending 31.12.2002. REL/HDEC formed a consortium. As a consortium they were required to comply with clause 7.2.2 which stipulated net cash profit at Rs. 200 crores. The said consortium has been excluded from the second stage of bidding on the ground that it has not fulfilled the said criteria mentioned in clause 7.2.2. The consortium had submitted their RFQ Document on 9.1.2005. The said consortium had submitted three audited accounts for the financial years ending 31.12.2001, 31.12.2002 & 31.12.2003. At this stage it may be noted that the financial year for REL ended on 31st March whereas the financial year for HDEC, Korea ended on 31st December.

5. At this stage, we may quote the relevant provisions of the PQ Document which read as under:

"Section 5.1 in the PQ document -

The objective of the Pre-Qualification is to qualify the applicants that have the necessary experience and financial and technical capabilities to undertake the work for which the Request for Proposal is to be invited.

Section 5.3.7 of the PQ document inter alia, provides:

No change in, or supplementary information to an application shall be accepted after its submission. However, MSRDC reserves a right to seek additional information from the applicants, if found necessary during the course of evaluation of the applicants.

Section 7.2.2 For Application by a Consortium In case of a Consortium, the entity declared as the Lead Member would be required to * hold a minimum of 26% of paid up and subscribed equity capital in the Project Company (MSRDC is of the view that a minimum paid up and subscribed capital of Rs.5000 million may be required for implementing the project.] until completion of construction and thereafter for a period of two years from the date of commencement of operations and * meet the financial eligibility criteria of Lead Member as detailed below In case of a Consortium, the following members taken together shall commit to hold majority (minimum of 51%) of the total paid up and subscribed equity capital in the Project Company until completion of construction and thereafter for a period of two years from the date of commencement of operations.

* Lead Member of the consortium committing to hold a minimum of 26% of the paid up and subscribed equity capital of the Project Company, until completion of construction and thereafter for a period of two years from the date of commencement of operations and meet the financial eligibility criteria of Lead Member as given below.

* Those members of the Consortium committing to hold a minimum of 5% of the paid up and subscribed equity capital of the Project Company until completion of construction and thereafter for a period of two years from the date of commencement of operations.

The aggregate (taken as the arithmetic sum) of Net Cash Profit and Net Worth as explained above) of all subsidiary companies in which the respective entities hold a minimum of 51% of total paid up and subscribed equity capital would also taken into consideration. In the case of financials of subsidiary companies being considered as above, the dividend paid by these subsidiary companies to the parent company will be deducted from the Net Profit of the parent company for the purpose of evaluation.

The financial evaluation criteria to be satisfied by a Consortium are detailed below.

Criteria To be satisfied by Amount Net worth (as per the latest audited balance sheet not earlier than the FY ended December 31, 2002) Lead Member (Holding a minimum of 26% equity in the project company) Total Consortium (to be satisfied together by the Lead member and those Consortium members committing to hold a minimum of 5% equity in the project company) Rs.2,000 million (or equivalent foreign currency) Rs.10,000 million (or equivalent foreign currency) AND Criteria To be satisfied by Amount Net cash profit (simple average of the audited financial figures over the last 3 financial years of 2 calendar months each, with the latest not earlier than the FY ended December 31, 2002, will be considered for this assessment).

Lead Member (Holding a minimum of 26% equity in the project company) Total Consortium (to be satisfied jointly by the Lead member and those Consortium members committing to hold a minimum of 5% equity in the project company) Rs.500 million (or equivalent foreign currency) Rs.2,000 million (or equivalent foreign currency) All figures quoted in a currency other than Indian National Rupees (INR) would be converted into Indian National Rupees (INR) at an exchange rate, which is the Telegraphic Transfer (ASSESSEE- COMPANY) buying rate of State Bank of India as on the Due Date. In the event of non-availability of exchange rate for any currency from the above source, MSRDC reserves the right to use available from any other source.

7.4 Basis of Evaluation The information to be provided by the Applicant must be in conformation with the following:

? The information provided by the applicant should be based on the latest available audited accounting statements.

? The latest audited accounting statements should not be dated earlier than 31st December, 2002.

? The Request for Qualification (RFQ) must be accompanied by the last three audited annual reports/accounts statements of the applicant and should include the financial statements of all subsidiary companies of the Applicant for the last three financial years. In case of a Consortium audited annual reports/account statements of each member of the Consortium for the last three financial years should be provided and should include the financial statement of all subsidiary companies of the entities forming the Consortium.

? The applicant (all members of Consortium) must submit information on all pending litigations or proceeding regarding liquidation, winding up, court receivership or other similar proceedings that should have been initiated or pending against the Applicant (or any member of Consortium). In addition to the above, information must also be provided of all pending litigations against the Applicant (or any member of Consortium) in which the maximum value of liability that may arise in the event of adverse judgment exceeds Rs.100 million (or equivalent foreign currency). A consistent history of litigation/arbitration awards against the applicant or any member of the consortium "

(emphasis supplied)

6. Briefly the criteria and conditions were as follows: "(a) In a consortium, the entity declared as "lead member" was required to hold the minimum of 26 per cent of paid-up and subscribed equity capital in the project company until completion of construction.

(b) The aggregate of net cash profit and net worth of the consortium was to be considered for evaluation of financial criteria of the consortium.

(c) Two criteria were required to be satisfied by the lead member (REL) as also the total consortium (REL/HDEC), namely, net worth and net cash profit.

(d) Net worth is defined as total paid-up share capital + reserves accumulated losses, revaluation of reserves and deferred revenue expenditure only to the extent of it being not written-off. Net worth was to be calculated as per the latest audited balance sheet not earlier than F.Y. ending 31st December, 2002.

(e) The leading member (REL) was required to have a net worth of Rs.200 crores and the total of Consortium (REL/HDEC) was required to have a net worth of Rs.1,000 crores. At this stage, we may clarify that this last criterion stands satisfied.

(f) As stated above, net cash profit of the lead member under the PQ document was stipulated at Rs.50 crores whereas for the Consortium it was Rs.200 crores.

(g) For the sake of convenience we quote the definition of NCP given in the PQ document which reads as follows:

"NCP = PAT (profit after tax) + depreciation + amortization, not in the form of cash transaction"

7. Therefore, the bidding process for selecting the BOT Concessionaire was in two stages. In the first stage MSRDC had to issue the Pre-Qualification (PQ) document with an invitation to prospective Applicants to submit their Request for Qualification (RFQ) for the Project. The prospective Applicants were required to submit their RFQ document on or before 10.1.2005. It was to be evaluated on technical and financial capability. Under clause 7.2.2 one of the criteria laid down was that the Consortium should have net cash profit (NCP) of Rs.2,000 million (Rs.200 crores). As per tender condition 7.2.2 the bidders were required to submit financial statement of three financial years subject to the condition that the latest should not be earlier than the financial year ending

31.12.2002. The choice of three years was left to the bidders. REL/HDEC exercised their option by submitting the financial statements of HDEC for three years, namely, 2001, 2002 and 2003.

8. HDEC had undertaken construction contracts in Iraq. On account of war in Iraq their annual report for the year 2001 showed negative income. However, the said Company achieved net profit of US$ 16 million in 2002, US$ 66 million in 2003 and US$ 164 million 2004. These figures have been taken from the letter of KPMG, Korea, dated 12.8.2005 giving a schedule of net income after adjusting expenses and income not in form of cash transaction. We quote hereinbelow the entire letter dated 12.8.2005 along with the schedule of net income which reads as under:

> "10th Floor, Star Tower, Tel +82 (2) 21120100 737 Yeoksam-dong, Fax +82(2) 21120101 Gangnam-gu, Seoul 135-984 www.kr.kpmg.com Republic of Korea The Board of Directors and Management Hyundai Engineering & Construction Co.,Ltd. 140-2 Kye-dong, Chongro-gu Seoul, 110-793, Korea August 12, 2005 Dear Sir, We have performed the procedures described below, which were agreed by Hyundai Engineering & Construction Co., Ltd. (the 'Company'). The sufficiency of the procedures is solely the responsibility of the Company. Consequently, we make no representation regarding the sufficiency of the procedures described below either for the purpose for which this report has been requested or for any other purpose.
>
> The procedures that we performed are as follows:
>
> We compared the statements of cash flows for years ended December 31, 2001, 2002, 2003 and 2004 prepared by the Company to the accompanying schedule of net income after adjusting expenses and income not in form of cash transaction which the company prepared according to the Pre-Qualification criteria for Mumbai Trans Harbour Link(MTHL) project in India. The financial statements of the company for years ended December 31, 2001, 2002, 2003 and 2004 were audited by us and we expressed an opinion that the financial statements of the Company for years ended December 31, 2001, 2002, 2003 and 2004 were presented fairly, in all material respects, in conformity with accounting standards generally accepted in the Republic of Korea.
>
> We audited the statements of cash flows for years ended December 31, 2001, 2002, 2003 and 2004 that under the indirect method of presenting the statements of cash flows, net income is adjusted to arrive at net cash flows from operating activities. The adjustments to net income I performed by removing the effects on net income of all items that included in net income that do not affect cash receipts and disbursements. (e.g., those that should be omitted altogether or categorized as investing or financing activities, such as adding depreciation and amortization).
>
> We found no exceptions as a result of the above agreed-upon procedures.

We were not engaged to, and did not perform an audit, the objective of which would be the expression of an opinion on the specified elements, accounts, or items. Accordingly, we do not express such an opinion. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you.

Accounting principles and auditing standards and their application in practice vary among countries. The financial statements are not intended to present the financial position, results of operations and cash flows in accordance with accounting principles and practices generally accepted in countries other than the Republic of Korea. In addition, the procedures and practices utilized in the Republic of Korea to audit such financial statements may differ from those generally accepted and applied in other countries. Accordingly, this report and the accompanying financial statements are for use by those knowledgeable about Korean accounting procedures and auditing standards and their application in practice.

This report is intended solely for the use of the Board of Directors and Management of Hyundai Engineering & Construction Co., Ltd., and should not be used by those who have not agreed to the procedures and taken responsibility for the sufficiency of the procedures for their purposes.

Very truly yours Sd/-

S.H. Goo,.

Partner (Attached: Cash flows from operating activities) (Attached) Schedule of net income after adjusting expenses and income not in form of cash transaction.

Description Dec 31st, 2001 Dec 31st, 2002 Dec 31st, 2003 Dec 31st, 2004 (1) Net Income (610,507) 15,963 65,546 164,248 (2) Expenses not in form of a cash transaction 686,310 200,753 199,084 285,039

- Provision for retirement and severance benefit 27,009 39,173 32,706 39,541

- Depreciation 49,475 36,221 31,279 27,699

- Stock compensation expense

-

- Bad debt expense 183,192 7,357 8,480

-

- Other bad debts expense 199,186

-

39,147 171,080

- Interest expense 48,803 23,899 20,683 18,723

- Loss on valuation of foreign currence 1,986

- Loss on disposal of trade note and accounts receivables 2,770 17,772 10,844

-

- Loss on valuation of inventories 39,762 20,485 5,364 20,308

- Loss on disposal of Investment securities

-

- Loss on investment securities impairment 61,104 29,900 12,845 2,348

- Loss on disposal of investment in affiliates using equity method

-

-

1,286

-

- Loss on disposal of investment assets 9,120 1,248

-

-

- Loss on valuation of investment in affiliates using equity method (*) 5,805

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-

- Loss on disposal of property, plant and equipment (*) 7,888 4,121 3,933 1,591

- Loss on impairment of property, plant and equipment

-

-

29,584 2,977

- Miscellaneous losses (including other extraordinary loss)

-

13,802 2,513

-

- Loss on prior year adjustment 42,047 4,700

-

-

(3) Income not in form of a cash transaction 337,982 76,284 44,486 55,723

- Interest income 2,860 2,117

- Gain on valuation of foreign currency

-

1,891

- Gain on disposal of investment assets 2,378 4,349

-

- Gain on disposal of property, plant and equipment (*) 27,846 47,589 5,740 7,982

- Gain on disposal of investment securities

-

-

-

- Reversal of loss on investment securities impairment 1,879

-

1,167 2,386

- Gain on valuation of investment in affiliates using equity method (*)

-

2,722 4,941 4,771

- Gain on Debt exemption (*) 305,317 6,987 30,342 18,164

- Gain on redemption of debentures

-

1,933

-

- Miscellaneous gains (Including other extraordinary gain)

-

-

-

19,729

- Gain on prior year adjustment

-

9,739

-

-

(4) Net income after adjusting expenses and income not in form of cash transaction [(1) + (2) (3)] (262,179) 140,432 220,143 393,564 (*) Gain on Debt exemption, Loss(gain) on valuation of investment affiliates using equity method. (Loss(gain) on disposal property, plant and equipment are included for calculation of net income after adjusting expenses and income not in form of cash transaction (Note) We translated Korean Won into U.S. dollars at the basic exchange rates on December 31, 2001, 2002, 2003 and 2004 to US$. The corresponding rates are as follows:

> Dec 31, 2001 Dec 31, 2002 Dec 31, 2003 Dec 31, 2004 W 1,326.1 to US$ 1 W 1,200.4 to US$ 1 W 1,197.8 to US$ 1 W 1,043.8 to US$ 1"
>
> (emphasis supplied)

9. At this stage, we need to clarify that HDEC had undertaken construction contracts in Iraq. That, large receivables had arisen prior to 1999 on account of war in Iraq. The Iraq contract receivables had nothing whatsoever to do with the three accounting years 2001, 2002 and 2003, therefore, there were no Iraq contract receivables nor was there any write-off as and by way of bad debt in any of the above three accounting years. Further, according to REL/HDEC, HDEC had incurred "non-cash expenses"

> amounting to US$ 686.310 million in 2001, US$ 200.753 million in 2002 and US$ 199.084 million in 2003 which did not involve direct cash outflow and, therefore, the said "non- cash expenses" ought to have been added back to NCP and if so added then the Consortium had NCP of Rs.2,000 million (Rs.200 crores) as mentioned in clause 7.2.2.

10. The aforestated contention advanced by the Consortium was rejected by M/s. Jean Muller Consultant of MSRDC in following words:

> "In case of 'Provision' for bad debts even though they are just 'Provision' but not a 'write-off', the same is treated as cash expense because once a 'Provision' has been made, the 'write-off' does not get routed through the profit and loss account. Moreover, the 'Provision' for bad debt relates to a revenue item that has already been treated as cash inflow on accrual basis."

11. In view of the position taken by MSRDC's Consultants, REL/HDEC stood excluded from the second stage of the bidding process.

12. To complete the chronology of events, by letter dated 22.6.2005, MSRDC informed REL/HDEC that their RFQ document was under scrutiny and accordingly REL/HDEC were requested to extend the validity of their Offer up to 6.10.2005. By letter dated 24.6.2005, MSRDC requested REL/HDEC

to submit further details and clarifications and accordingly the Consortium of REL/HDEC was once again requested to extend the validity of their Offer till 6.10.2005. Accordingly, by letter dated 18.7.2005, REL/HDEC extended the validity of their Offer up to 6.10.2005 (90 days). By another letter dated 6.8.2005, MSRDC sought clarifications from REL/HDEC in respect of certain financial aspects and the said Consortium was given time up to 19.8.2005 to furnish such clarifications. By the said letter, MSRDC stated that there were no queries in respect of REL, but there were queries in respect of HDEC. By the said letter, MSRDC referred to the break-up of net cash profit submitted by REL/HDEC and asked for the basis for classifying certain heads of expenditure under the heading "non-cash expenditure". By reply dated 18.8.2005, REL/HDEC submitted its clarification by pointing out that as on 10.1.2005 when RFQ document was submitted the audited accounts for FY ending 31.12.2004 were not ready, so far as HDEC was concerned and, therefore, it had submitted the audited accounts of HDEC for the years 2001, 2002 and 2003. By the said letter dated 18.8.2005, the REL/HDEC also submitted audited accounts of HDEC for FY ending 31.12.2004. In other words, by 18.8.2005 (i.e. before 6.10.2005 which was date up to which REL/HDEC had kept its Offer open) the said Consortium had submitted the audited accounts for the financial years ending 31st December 2002, 2003 and 2004. Therefore, according to REL/HDEC, they had also complied with the conditions mentioned in the PQ document by supplying audited account for the reference years, namely, 2002, 2003 and 2004.

13. Since REL/HDEC did not submit audited accounts concerning HDEC for the financial year ending 31.12.2004 by 10.1.2005, the Consultants of MSRDC took the position that REL/HDEC were not entitled to bid in the second stage of the bidding process. According to the said Consultants, the audited accounts of HDEC for the FY 31.12.2004 constituted subsequent information (i.e. information supplied after the cut-off date of 10.1.2005) and, therefore, REL/HDEC stood excluded from the second stage of the bidding process.

14. On 22.8.2005, a committee by the name "Peer Committee" was constituted by MSRDC to review the draft evaluation report submitted by the consultants, M/s. Jean Muller Consortium, relating to pre-qualification of bidders to suggest process of evaluation and to provide recommendations to MSRDC. The said Committee met on 21.9.2005. The consultants M/s. Jean Muller Consortium and M/s. Crisil were both called to give clarifications. The said Committee was headed by Mr. Justice R.J. Kochar, Judge of Bombay High Court (retired), Shri A.K. Banerjee (Technical Member) in NHAI, Mr. R.S. Agarwal, Executive Director of IDBI (retired), Mr. V. Giriraj, Joint Managing Director of MSRDC etc. The Committee noted that pre-qualifications bids were received only from six Applicants, one of them was REL/HDEC. The Committee noted that while Indian companies could submit their audited accounts up to 31.3.2004 as their FY ended on 31st March the foreign companies could submit their audited accounts only up to 31.12.2003 as their FY ended on 31st December. The Committee further observed that although the cut-off date was 10.1.2005, clarifications on break-up of non- cash expenses were sought from REL/HDEC up to 22.8.2005 and since in the mean time audited accounting statements were furnished by HDEC up to 31.12.2004, the same could be considered for evaluation. The Peer Committee did not agree with the opinion expressed by MSRDC's Consultants that the loss incurred by HDEC for the financial year ending 31.12.2001 would have a cash impact in future. At this stage, we may reiterate that even according to the Consultants of MSRDC, provision for bad debt may not involve cash outflow in the year of

incidence but it would have cash impact at a future date and, therefore, out of abundant caution they decided to exclude REL/HDEC. However, the Peer Committee did not concur with this accounting interpretation. According to the Peer Committee the major provision for bad debt was in the accounts for the year 2001 and it related to receivables from their contract in Iraq affected by war and since it was only a provision for bad debt and not a write-off, the Committee came to the conclusion that there would be no cash impact in future. The Committee took the view that even without taking into account the audited accounts for the year 2004, REL/HDEC fulfilled the financial criteria in clause 7.2.2. Accordingly, the Peer Committee opined that REL/HDEC should not be excluded from the second stage of the bidding process. At this stage, it may be noted that after receipt of the said report, made by the Peer Committee dated 1.10.2005, MSRDC placed the report of the Peer Committee before their Consultants. Needless to add that the Consultants of MSRDC retained their original position, namely, that since the audited accounts for the year ending 31.12.2004 could not have been submitted after 10.1.2005, the said accounts of HDEC could not have been taken into account as it would violate the tender conditions and, therefore, REL/HDEC should be excluded from the second stage of the bidding process.

15. By letter dated 28.9.2005, in view of the position taken by their Consultants, MSRDC requested REL/HDEC to extend the validity of their Offer for further six months as they wanted to study the implications arising from the audited accounts submitted by HDEC for the year ending 31.12.2004. MSRDC basically wanted to know as to what would be cash impact of the provision for bad debts in the accounts of HDEC for the year 2001. Accordingly by letter dated 6.10.2005, REL/HDEC extended the validity of their Offer up to 6.4.2006. Ultimately, by letter dated 7.11.2006, MSRDC informed REL/HDEC that they stood disqualified as they had failed to meet the qualification criteria.

16. In the circumstances, REL/HDEC moved the Bombay High Court vide Writ Petition No.39 of 2007 in which they alleged that a decision to disqualify, taken by MSRDC, was arbitrary, unjustified and contrary to the terms of the tender documents; that REL/HDEC met the financial criteria specified by MSRDC both in terms of the original submission of RFQ document made on 9.1.2005 and further information given to MSRDC; that in the alternative the decision of MSRDC was unjustified and incorrect, particularly when the Consortium had given audited accounts of HDEC for the FY ending 31.12.2004 and, therefore, on the said basis it was not open to MSRDC to exclude REL/HDEC from the second stage of the bidding process. It was further submitted in the said writ petition that the PQ document did not specify any accounting standard (AS) and in the circumstances it was not open to MSRDC to exclude REL/HDEC by applying AS No.26; that the accounts of HDEC indicated "net profits" for the FY ending December 31 2002, 2003 and 2004 and on that basis it had calculated NCP in accordance with internationally accepted ASs (GAPP) which has been certified by KPMG, Chartered Accountants in Korea. According to REL/HDEC, no particular AS was mentioned in the PQ document and, therefore, it was implied that the Consortium were free to adopt GAAP. That, in the circumstances, the impugned decision taken by MSRDC was arbitrary, unjust and wrongful and contrary to the tender document (PQ document) issued by MSRDC.

17. By the impugned judgment dated 4.6.2007, the High Court ruled that admittedly HDEC had suffered net loss of approximately US$ 610 million in 2001; that they had earned net profits in 2002, 2003 and 2004; that audited accounts for 2004 were made available only after 10.1.2005 and, therefore, could not have been taken into account by the Peer Committee and, therefore, MSRDC was right in excluding REL/HDEC from the second stage of the bidding process. According to the impugned judgment, the basic debate was about accounting treatment to be given to "non-cash expenses". The High Court was of the view that it had no jurisdiction under Article 226 of the Constitution to interfere with the decision of MSRDC, particularly, when there were two different opinions regarding adjustment to net income. According to the High Court, the decision of MSRDC on the future cash impact of "the provision for bad debts" made by HDEC in its accounts for 2001 cannot be said to be arbitrary or unreasonable. For the aforestated reasons, without going into the question whether provision for bad debts is or is not a "non-cash expense" liable to be added back to arrive at net cash profit, the High Court dismissed the writ petition, hence this civil appeal.

18. Mr. K.K. Venugopal, learned senior counsel appearing on behalf of REL/HDEC (Consortium), submitted that the decision-making process stood vitiated for the reason that the report of the Peer Committee, which disagreed with the Consultants of MSRDC, was not referred to an independent firm of chartered accountants. That, Crisil was rating agency and not chartered accountants. He submitted, in this connection, that it was obvious to MSRDC that Crisil had already taken a position in its first report that REL/HDEC were disqualified and, therefore, fairness and transparency which are important aspects of Article 14 of the Constitution required MSRDC to have placed both the reports of Crisil and the Peer Committee, before any independent firm of chartered accountants. Learned counsel submitted that by not doing so the decision-making process itself stood vitiated. In any event, learned counsel urged that Crisil was wrong if one looks at the audited balance sheet of HDEC for the accounting year ending 31.12.2004. Learned counsel urged that even according to Crisil the provisioning for bad debts was "non-cash expense", however, according to Crisil, such provisioning could have a cash impact in future years. Learned counsel submitted that the conclusion of Crisil, namely, that such provisioning could have a cash impact in future years was unjustified if one takes into account the audited balance sheet for the year ending 31.12.2004. Therefore, according to the learned counsel, the decision of Crisil was arbitrary, since, its conclusion was not based on application of proper AS. Learned counsel further submitted that when the entire basis of Crisil's report against HDEC was on the issue of future cash impact, the decision to exclude the audited accounts for the FY 2004, clearly vitiated the decision-making process. In the alternative, learned counsel submitted that in any case where two views are possible, the view holding that the person/party concerned should not be disqualified, should be accepted as disqualification prevents the applicant from participating in the bidding process, it affects its fundamental rights under Article 19(1)(g) of the Constitution as also larger public interest including State finances which ultimately makes MSRDC a loser.

19. Mr. S. Ganesh, learned senior counsel appearing on behalf of REL/HDEC, submitted that provision for doubtful debts in the present case has not been written-off till 31.12.2004; that by adding back provision for doubtful debts made by HDEC in 2001, the Consortium had met the requirement of NCP for the years 2001, 2002 and 2003; that the said provision was made only in the accounts of 2001; that Iraq contract receivables had nothing to do with the years 2001, 2002 and

2003 (reference years); that provision for doubtful debts is only appropriation of profits and not a charge on profits and that in fact regarded as "Reserve" for purpose of "sur-tax" and since it is only appropriation the amount under it has to be added back to determine the NCP in terms of the definition in the PQ document. Learned counsel further urged that provision for doubtful debts ought to be included in the net profit; that since NCP is always more than the net profit it is obvious that the said provision for doubtful debt has to be included in the NCP. Learned counsel further urged that there was no "write-off" during 2001, 2002 and 2003 and, therefore, during those years there was no cash impact on the cash profit of REL/HDEC or on the net profit of the said Consortium.

20. Mr. Altaf Ahmed, learned senior counsel appearing on behalf of the MSRDC submitted that REL/HDEC had failed to satisfy clause 7.2.2 of the PQ document and, therefore, they were disqualified rightly. It was urged that the evaluation of prequalification criteria was done by reputed international consultants, namely, M/s. Jean Muller which in turn took opinion from Crisil. The entire exercise was carried out by experts and according to the recommendations of Crisil, duly accepted by the consultants, the impugned decision was taken and, therefore, the High Court was right in refusing to intervene under Article 226 to the Constitution. Learned counsel submitted that the failure to satisfy the financial criteria laid down in clause 7.2.2 was the decision of the consultants and not the decision of MSRDC which had merely acted on the basis of evaluation done by the consultants and, therefore, it cannot be said that the impugned decision taken by MSRDC was arbitrary or unjustified. Learned counsel submitted that according to the opinion expressed by the consultants, the financial position of HDEC for the year ending 31st December 2001 was poor and the provisioning made by HDEC for the years 1999, 2000 and 2001 would have future cash impact. This was the view of the experts which MSRDC accepted. That, the entire process was transparent and every aspect was considered. There were detailed discussions during the decision-making process. Queries were raised from time to time. Explanations and clarifications were sought from time to time. Full opportunity was given to the Consortium to put forth their case. In the circumstances, learned counsel submitted it cannot be said that the decision- making process was faulty, arbitrary, unjust or wrongful. Learned counsel next contended that the cut-off date was 10.1.2005. That cut-off date, according to the learned counsel, was applicable in the case of all the six bidders. Hence, it was not possible to look into the audited balance sheet for the year 2004 which was placed by the Consortium only in August 2005. In other words, learned counsel submitted that the audited balance sheet for the year 31st December, 2004 could not have been taken into account after the cut-off date. This was the view of the Consultants for MSRDC and that view has been accepted by MSRDC.

21. Learned counsel submitted that Mumbai Trans Harbour Link (MTHL) Project is based on BOT, therefore, global tenders were invited. It is an important project which is required to be given to the bidder who qualifies and goes successfully through both the stages of the bidding process; that REL had entered into an agreement with HDEC; that it was a consortium; that the said Consortium did not fulfill the financial criteria of Rs.200 crores (NCP); that according to the annual accounts of HDEC there was a loss of US$ 610 million in the year 2001; that in Form F-S submitted by the appellant's Consortium, non-cash expenses for financial years ending December 31 - 2001, 2002 and 2003 in respect of HDEC were US$ 686 million, US$ 201 million and US$ 199 million

respectively which cannot be added back to net profit/loss. Learned counsel further contended that according to the Consultants of MSRDC "adding back" was not permissible and even if it is held to be permissible it is not advisable as it would result in future cash impact on the net profits of HDEC. Learned counsel submitted that provision for bad debts were examined by the consultants and upon examination of bad debts expenses, the consultants opined that the said expenses may not involve a direct cash outflow in the year of incidence but they may have a cash impact at a future date and hence they cannot be treated as non-cash expenses. Learned counsel submitted that there is a difference between "cash expense" and "non-cash expense". The distinction lies in the answer to the question as to whether there is a cash impact in the current year or future years and if it has cash impact at a future date then it would constitute an item of cash expense, even though in the year of incidence the item may be non-cash expense. Therefore, the impugned decision, namely, that REL/HDEC did not satisfy the financial criteria under clause 7.2.2, was right. Learned counsel lastly submitted that bad debt expenses did not qualify as "amortization" and, therefore, such provision cannot be added back to net profits of HDEC. Learned counsel lastly submitted that in the present case that Consultants of MSRDC had rightly relied on AS 26 under which the terms "amortization" and "write-off" are interchangeable and, therefore, provisioning for doubtful debts did not constitute "amortization" and, therefore, it could not have been added back to the net profits, particularly when the definition of NCP in the tender document defined NCP to mean "PAT + depreciation + amortization, not in the form of cash transaction".

22. We find merit in this civil appeal. Standards applied by courts in judicial review must be justified by constitutional principles which govern the proper exercise of public power in a democracy. Article 14 of the Constitution embodies the principle of "non-discrimination". However, it is not a free- standing provision. It has to be read in conjunction with rights conferred by other articles like Article 21 of the Constitution. The said Article 21 refers to "right to life". In includes "opportunity". In our view, as held in the latest judgment of the Constitution Bench of nine-Judges in the case of I.R. Coelho vs. State of Tamil Nadu (2007) 2 SCC 1, Article 21/14 is the heart of the chapter on fundamental rights. It covers various aspects of life. "Level playing field" is an important concept while construing Article 19(1)(g) of the Constitution. It is this doctrine which is invoked by REL/HDEC in the present case. When Article 19(1)(g) confers fundamental right to carry on business to a company, it is entitled to invoke the said doctrine of "level playing field". We may clarify that this doctrine is, however, subject to public interest. In the world of globalization, competition is an important factor to be kept in mind. The doctrine of "level playing field" is an important doctrine which is embodied in Article 19(1)(g) of the Constitution. This is because the said doctrine provides space within which equally-placed competitors are allowed to bid so as to subserve the larger public interest. "Globalization", in essence, is liberalization of trade. Today India has dismantled licence-raj. The economic reforms introduced after 1992 have brought in the concept of "globalization". Decisions or acts which results in unequal and discriminatory treatment, would violate the doctrine of "level playing field" embodied in Article 19(1)(g). Time has come, therefore, to say that Article 14 which refers to the principle of "equality" should not be read as a stand alone item but it should be read in conjunction with Article 21 which embodies several aspects of life. There is one more aspect which needs to be mentioned in the matter of implementation of the aforestated doctrine of "level playing field". According to Lord Goldsmith - commitment to "rule of law" is the heart of parliamentary democracy. One of the important elements of the "rule of law" is legal

certainty. Article 14 applies to government policies and if the policy or act of the government, even in contractual matters, fails to satisfy the test of "reasonableness", then such an act or decision would be unconstitutional.

23. In the case of Union of India and another vs. International Trading Co. and another - (2003) 5 SCC 437, the Division Bench of this Court speaking through Pasayat, J. had held :

> "14. It is trite law that Article 14 of the Constitution applies also to matters of governmental policy and if the policy or any action of the Government, even in contractual matters, fails to satisfy the test of reasonableness, it would be unconstitutional.
>
> 15. While the discretion to change the policy in exercise of the executive power, when not trammelled by any statute or rule is wide enough, what is imperative and implicit in terms of Article 14 is that a change in policy must be made fairly and should not give impression that it was so done arbitrarily or by any ulterior criteria. The wide sweep of Article 14 and the requirement of every State action qualifying for its validity on this touchstone irrespective of the field of activity of the State is an accepted tenet. The basic requirement of Article 14 is fairness in action by the state, and non-arbitrariness in essence and substance is the heart beat of fair play. Actions are amenable, in the panorama of judicial review only to the extent that the State must act validly for a discernible reasons, not whimsically for any ulterior purpose. The meaning and true import and concept of arbitrariness is more easily visualized than precisely defined. A question whether the impugned action is arbitrary or not is to be ultimately answered on the facts and circumstances of a given case. A basic and obvious test to apply in such cases is to see whether there is any discernible principle emerging from the impugned action and if so, does it really satisfy the test of reasonableness."

24. When tenders are invited, the terms and conditions must indicate with legal certainty, norms and benchmarks. This "legal certainty" is an important aspect of the rule of law. If there is vagueness or subjectivity in the said norms it may result in unequal and discriminatory treatment. It may violate doctrine of "level playing field".

25. In the case of Reliance Airport Developers (P) Ltd. v. Airports Authority of India and others -(2006) 10 SCC 1, the Division Bench of this Court has held that in matters of judicial review the basic test is to see whether there is any infirmity in the decision-making process and not in the decision itself. This means that the decision-maker must understand correctly the law that regulates his decision- making power and he must give effect to it otherwise it may result in illegality. The principle of "judicial review" cannot be denied even in contractual matters or matters in which the Government exercises its contractual powers, but judicial review is intended to prevent arbitrariness and it must be exercised in larger public interest. Expression of different views and opinions in exercise of contractual powers may be there, however, such difference of opinion must be based on specified norms. Those norms may be legal norms or accounting norms. As long as the norms are

clear and properly understood by the decision-maker and the bidders and other stakeholders, uncertainty and thereby breach of rule of law will not arise. The grounds upon which administrative action is subjected to control by judicial review are classifiable broadly under three heads, namely, illegality, irrationality and procedural impropriety. In the said judgment it has been held that all errors of law are jurisdictional errors. One of the important principles laid down in the aforesaid judgment is that whenever a norm/benchmark is prescribed in the tender process in order to provide certainty that norm/standard should be clear. As stated above "certainty" is an important aspect of rule of law. In the case of Reliance Airport Developers (supra), the scoring system formed part of the evaluation process. The object of that system was to provide identification of factors, allocation of marks of each of the said factors and giving of marks had different stages. Objectivity was thus provided.

26. One of the points which arise for determination in this case is whether the criteria of objectivity stand satisfied in the present case. "Profit/net income" and "cash" are concepts. However, there is a difference. "Profit" is based on "value judgment" whereas "cash" is "fact-specific". In the PQ document, "net cash profit" has been defined to mean - "PAT + depreciation + amortization, not arising from cash transaction". The last five words which have underlined are descriptive. They merely indicate the meaning of "amortization". It is not in dispute that depreciation and amortization are "non-cash expenses".

27. In the present case, REL/HDEC claims adding back of the non-cash expenses of US$ 686,310 million for the year 2001, of US$ 200,753 million for the year 2002 and of US$ 199,084 million in the year 2003, to the net loss of US$ 610,507 million; net profit of US$ 15,963 million and US$ 65,545 million during the years 2001, 2002 and 2003. However, according to the Consultants of MSRDC, such "add back" was not possible because even though provisions are not "write-offs" the former should be treated as cash expense because once a provision is made, the "write-off" does not get routed through the P&L account and that in any event if such add back is allowed then it would result in "cash impact" in future.

28. To answer the first point we need to know what is "provision" and how it is made.

29. "Provisioning" is a matter of estimation. ASs are policy documents. Accounting interpretation depends on application of several ASs simultaneously. The concept of "amortization" is not restricted only to AS 26. Similarly, the concept of "cash flow analysis" is not restricted to AS 3. Therefore, different methods are prescribed for estimating net profits and/or net cash profits. There are no two views on this point. Provisioning for doubtful debts cannot be equated to "write- off". In the case of provisioning there is no "cash outflow". This proposition is undisputed. What is being argued is that once there is "provisioning", the "write-off" does not get routed through the P&L account and, therefore, there will be cash impact in future. This argument amounts to begging the question. If this argument is to be accepted then we are obliterating the difference between "provisioning" and "write- offs". The question of "cash impact" in future is a separate question. It has to be answered in terms of "cash flow reporting" which falls in AS 3 which has been invoked by the chartered accountants of REL/HDEC. In the case of Commissioner of Income-tax and Excess Profits Tax, Central, Bombay v. Jwala Prasad Tiwari 1953 (24) ITR 537, the Division Bench of the

Bombay High Court speaking through Chagla, C.J. has held as follows:

> "'Writing Off' is a technical term used by financiers and auditors. There are two methods of dealing with a debt which has been written off in the books of account, (1) by giving the corresponding credit to the debtor's account, and (2) by giving the corresponding credit to the bad and doubtful debts account. The first method is only employed where it is desired to close the account of the debtor. The second method is employed where there are some chances of recovery, howsoever remote they may be.
>
> When we talk of 'writing off' we are not concerned with the credit to be given to an account. 'Writing off' means the raising of a debit entry. This can only be to the debit of the profit and loss account. This is the only debit which can possibly be raised as a result of writing off a bad debt."

30. In the case of Metal Box Company of India Ltd. v. Their Workmen 1969 (73) ITR 53, this Court has brought out succinctly difference between "provision" and "reserve" as follows:

> "The next question is whether the amount so provided is a provision or a reserve. The distinction between a provision and a reserve is in commercial accountancy fairly well known. Provisions made against anticipated losses and contingencies are charges against profits and, therefore, to be taken into account against gross receipts in the P. & L. account and the balance sheet. On the other hand, reserves are appropriations of profits, the assets by which they are represented being retained to form part of the capital employed in the business. Provisions are usually shown in the balance-sheet by way of deductions from the assets in respect of which they are made whereas general reserves and reserve funds are shown as part of the proprietor's interest (see Spicer and Pegler's Book-keeping and Accounts, 15th edition, page 42). An amount set aside out of profits and other surpluses, not designed to meet a liability, contingency, commitment or diminution in value of assets known to exist at the date of the balance-sheet is a reserve but an amount set aside out of profits and other surpluses to provide for any known liability of which the amount cannot be determined with substantial accuracy is a provision: (see William Pickles Accountancy, second edition, p. 192 ; Part III, clause 7, Schedule VI to the Companies Act, 1956, which defines provision and reserve)."

31. Applying the tests laid down in the aforesaid two judgments [Jwala Prasad (supra) and Metal Box (supra)] it is clear that the concept of "provision for doubtful debts" is different from the concept of "write-off". The effect of the two is quite different. Provisions made against anticipated losses are charges against profits and, therefore, to be taken into account against gross receipts in the P&L account and the balance-sheet. "Provisions" are usually shown in the balance- sheet by way of deduction from the assets whereas "reserves" are shown as part of the interest of the proprietor. In the present case, there is no dispute regarding the aforestated concepts. However, according to the consultants for MSRDC though provision for doubtful debt is a non-cash expense it has to be treated as a cash expense because once a provision has been made, the write-offs cannot be routed

through P&L account and, therefore, what is conceptually a non-cash expense is being treated as a cash expense. As stated above, this is begging the question. If the aforestated argument is to be accepted it would obliterate the conceptual difference between "provision" and "write-off". The above reasoning shows that the only reason for excluding REL/HDEC is the future cash impact of the provision made in the accounts of HDEC for the FY 2001. This aspect has been discussed by us in the following paragraphs.

32. On the second question of future cash impact it may be reiterated that KPMG, the chartered accountants for REL/HDEC has invoked the principle of "cash flow reporting"

> which also finds place in AS 3. According to the said principle of "cash flow reporting", when P&L accounts and balance- sheets are prepared on accrual basis, revenues and expenses are recognized on accrual basis, i.e., when the transaction or event occurs. However, timing of cash flow is not reckoned in such system of accounting. Similarly, in cases where accounts are based on accrual system of accounting, recognition of assets and liabilities is not dependent on the actual timing of cash spent on capital expenditure and cash inflow on account of capital receipt. Thus the financial statements prepared on accrual basis do not reflect the timing of the cash flow and amount of cash flow. The object of the cash flow statement is to assess the company's ability to generate the cash flow in future and to assess reasons for difference between "net profit" and "net cash flow" from operations.

33. "Operating cash profit" can be derived by either "Direct Method" in which cash items of cash inflow are listed like cash received from customers, payment of interest etc. as against cash outflows like payment to supplier, payment for taxes etc. or by "Indirect Method" which is also known as "Reconciliation Method" in which the "operating cash profit" is derived by adding to the net profit non-cash items like provision for taxes, provision for doubtful debts, loss on sale of fixed assets and investments, depreciation, amortization of intangibles etc. because these items do not affect cash. Similarly, profit on the sale of fixed assets and investments are deducted from the net income figure as these items also do not affect cash. Similarly, adjustments in respect of current assets and liabilities are also required to make to net income (loss) figure to arrive at cash profits. Both the methods give the same results in respect of the final total.

34. We quote hereinbelow some of the illustrations of "Indirect Method" which shows that provision for bad debts can be added back to "net profit" in order to arrive at "net cash" from operating activities:

> (1) "Advance Accounts" by Shukla, Grewal and Gupta, Vol.II, Edition 2008, pages 23.20 - 23.21, which read as under:
>
> ""(ii) Indirect Method:
>
> Zed Ltd.

Cash Flow Statement for the year ended 31st March, 2001 Rs.

Rs.

Cash Flows from Operating Activities Net profit before income tax and extra-ordinary item:

Adjustments for:

Depreciation Provision for bad debts Underwriting commission amortised Profit on sale of investments Income from investments Interest on debentures Operating profit before working capital changes Adjustments for:

Increase in inventory Increase in trade debtors Increase in trade creditors Increase in outstanding expenses Cash inflow from operations Income tax paid Cash flow from extraordinary item: Compensation recd. in lawsuit Net cash from operating activities Cash Flows from Investing Activities Purchase of fixed assets Sale proceeds of investments Interest recd. on investments* Net cash used in investing activities Cash Flows from Financing Activities Redemption of debentures at par* Interest on debentures paid Dividends and corporate dividend tax paid Net cash used in financing activities Net increase in cash and cash equivalents Cash and cash equivalents as on 31st March,2000 (Opening Balance) Cash and cash equivalents as on 31st March,2001(Closing Balance) 7,77,000 1,80,000 1,000 1,200 (7,500) (21,000) _____66,000 9,96,700 (93,800) (20,000) 19,200 _______5,600 9,07,700 ___(4,16,000) 4,91,700 _____55,000 (2,00,000) 1,57,500 _____21,000 (1,00,000) (66,000) ___(3,30,000) 5,46,700 (21,500) ____(4,96,000) 29,200 ______1,64,200 ______1,93,400 *Alternatively, interest received on investments and interest paid on debentures may be treated as flows from operating activities.

Working Notes:

(i) Net profit before income-tax and extraordinary item: Rs.

Net profit before income tax 8,32,000 Less: Compensation received in lawsuit 55,000 7,77,000 Working notes (iii), (iv) and (v) as prepared under the direct method are also relevant under the indirect method." (emphasis supplied) (2) "Fundamentals of Corporate Accounting" by J.R. Monga, 11 Edition 2005-06, pages 12.15, 12.16, 12.17, 12.20, which read as under:

"12.15.

CASH FLOWS FROM PERATING ACTIVITIES [CASH PROVIDED BY (OR USED IN) OPERATING ACTIVITIES] One of the major items of information in the cash flow statement is the net cash flow provided by (or used in) operating activities. In fact it is the regular source of cash in any enterprise that determines whether or not an enterprise will continue to exist in the long run. The logic for determining the net cash flow from operating activities is to understand why net profit (loss) as reported in the profit and loss account must be converted. As we know that financial statements are generally prepared on accrual basis of accounting which requires that revenues be recorded when earned and the expenses be recorded when incurred. Earned revenues more often include credit sales that have not been collected in cash and expenses incurred that may not have been paid in cash during the accounting period. Thus under accrual basis of accounting net income will not indicate the net cash provided by operating activities or net loss will not indicate the net cash used in operating activities. In order to calculate the net cash provided by (or used in) operating activities, it is necessary to replace revenues and expenses on accrual basis with actual receipts and actual payments in cash. This is done by eliminating the non-cash revenues and non-cash expenses from the given earned revenues and incurred expenses in the profit and loss account. In addition to regular non-cash revenue and non-cash expense items, the profit and loss account is also debited and credited with purely non-cash items which reduce and increase the profits respectively but do not affect the cash at al e.g. depreciation, loss (or profit) on the sale of fixed assets, amortization of intangible assets like goodwill, patents trademarks etc. deferred revenue expenditures like preliminary expenses, discount on the issue of shares and debentures and so on. Since cash provided by operations is to be calculated, certain non-operating items like rent income, interest income, dividend income, refund of tax etc. should also be adjusted although these items may have been recorded on cash basis. Such items are analysed separately in the cash flow statement as operating, investing and investing activities.

ATTENTION PLEASE The term 'operating activities' means business transactions pertaining to regular business activities, e.g., purchase and sale of goods and services.

DIRECT VS. INDIRECT METHOD There are two method of preparing the Cash Flow Statement. Both methods give the identical or same results in respect of the final total as well as the sub-totals of the three sections operating, investing and the financing. They differ only in the manner the data or information is presented in Cash Flows from Operating Activities section.

The direct method lists separately each significant cash inflows and outflows from operating activities, e.g., Cash inflows :

(i) Cash received from customers

(ii) Receipts of interest payments

(iii) Receipts of cash dividends on investment in the shares of other companies Cash outflows :

(i) Payments to suppliers for goods purchased

(ii) Payments for operating expenses

(iii) Payments for interest

(iv) Payments for taxes The outflows (payments) are subtracted forms the inflows (receipts) to determine the net cash provided (or used) by operating activities."

"12.16-12.17. The indirect method provides less information because it does not disclose the individual cash inflows and cash outflows from the operating activities. Instead under this method we start with net profit (or loss) and adjusts this figure to obtain net cash flows from operating activities. The indirect method is also known as 'Reconciliation Method' because it involves reconciliation between net profit (or loss) as given in the profit and loss account and the net cash flow from operating activities as calculated on the cash flow statement.

DIRECT VS. INDIRECT METHODS Direct Method Cash Flows from operating Activities (A) Cash receipts from customers.

(B) Cash paid to suppliers and employees. (A-B) Cash generated from operations.

Less: Interest and tax.

(C) Cash before extraordinary items. Adjust for extraordinary items to get:

(1) Net cash from operations.

(2) Net cash from (used on) investing activities. (3) Net cash from (used on) financing activities.

(D) Net increase (decrease) in cash and cash equivalents (1+2+3) Opening balance of cash and cash equivalents.

Closing balance of cash and cash equivalents.

Indirect Method Net Profit as per Profit and Loss Account Adjusted for:

Provision for tax Provision for doubtful debts.

Profit (Loss) on sale of fixed assets.

Depreciation Profit (loss) on sale of investments.

Interest expenses.

Exchange rate effect Dividend income.

Interest income.

Leave salary provision (earlier year) Operating profit before working capital change. Adjusted for:

Trade and other receivable.

Inventories and other current assets. Trade payables and other current liabilities. Cash generated from operations. Income tax paid (Net of refunds) The above provides:

Cash flow before extraordinary items. Adjust for extraordinary items to get. Net cash from operating Activities.

There are two stages for achieving the net cash flows from operating activities:

Stage-1: Calculation of operating (cash) profit before working capital changes, by adding to net profit as reported in the profit and loss account, non-cash charges: depreciation, amortization of intangible assets, loss on the sale of fixed assets and long term investments, provision for tax and dividends and the like because these items do not affect cash. Similarly profit on the sale of fixed assets and long term investments are deducted from the net income figure as these items also do not affect cash. In fact, it is a partial conversion of accrual basis profit to cash basis profit. Such adjustments are made by analyzing individual non cash items in journal to find out the absence of cash in these items. Moreover, non-operating items (also known as extraordinary items) like rental income, interest income, dividend income are deducted from the reported net income figure because these items are disclosed separately on the cash flow statement. The net result of these adjustments is operating (cash) profit before working capital changes.

Some of the significant non-cash items are explained in the following paragraphs followed by adjustment of current operating assets and liabilities. (See Stage II).

Depreciation: This item of expense reduces the profit since it is a charge made against revenue for the use of tangible fixed assets. The likely journal entry to record the depreciation expense is:

(i) Depreciation Account Dr. To Provision for Depreciation Account (or Accumulated Depreciation) Alternatively Depreciation Account Dr. To Fixed Asset Account In either case the depreciation account would be closed be transfer to Profit and Loss

Account. The net affect would be:

```
                  Either
          Profit and Loss Account                                   Dr.
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To Provision for Depreciation Account Or Profit and Loss Account Dr. To Fixed Asset Account It is clear that cash is not affected in the above journal entries. The depreciation does not require any expenditure in cash. Thus, the amount of depreciation charge must be added to be reported net income in order to arrive at the total increase in cash provided from the operations.

Amortization of intangibles-goodwill, patents, etc.: The amortization of (i.e., writing off) goodwill, trade marks, patents copyrights, etc., has the same effect as the depreciation expense. The amount of amortization reduces the profit but does not involve any flow of cash as is evident from the following entry:

Profit and Loss Account Dr. To Goodwill etc. Account There is no change in cash. Thus amount of intangibles so written off must also be added back to the reported net profit (income)."

"12.20.Stage-2 : Adjustments in respect of current assets and current liabilities : The adjustments made in the net profit (income) figure as per profit and loss account as outlined in Stage-I above, gives As Operating Profit before Working Capital Changes. Several other adjustments are made in respect of current (Operating) assets (e.g., debtors, bills receivable, inventories, prepayments etc.) and current (Operating) liabilities (e.g., creditors bills payable, outstanding liabilities etc.) to obtain the final net cash from operating activities. There is an intimate relationship between the revenue and expense items of income statement and current assets and current liabilities items of the balance sheet. Since the income statement is prepared on the accrual basis, the resultant net income figure is affected by cash and non-cash items. But the net income on a cash basis considers only cash receipts as revenue and subtracts from cash receipts only cash spent for purchase of goods or raw materials) and expenses.

The following general rules, as an aid to analysis of current assets and current liabilities affecting cash, may be noted :

(i) An increase in an item of current asset causes a decrease in cash inflow because cash is blocked in current assets.

(ii) A decrease in an item of current asset causes an increase in cash inflow because cash is released from the sale or recovery from current asset.

(iii) An increase in an item of current liability causes a decrease in cash outflow because cash is saved.

(iv) A decrease in an item of current liability causes increases in cash outflow because of payment of liability.

Some of the adjustments are discussed below :

(i) Debtors and Bills Receivable (Credit Sales) : It needs no explanation that the major source of cash from operations is cash sales. But it is not uncommon to find a significant amount of credit sales in the form of debtors and bills receivable representing current assets. This indicates that the sales were made both for cash and credit. Consequently the net income (or profit) figure does not disclose the cash from operations. The following adjustment, however, enables to overcome this difficulty :

Cash from Operations = Operating Profit before Working Capital Changes + Net Decrease in Debtors and Bills Receivable." (emphasis supplied)

35. Taking into account the above principles, it is clear that there are two methods of "cash flow reporting" i.e. direct and indirect. Both give identical results in the matter of the final total. They differ only in presentation of the data. They differ only in presentation of the data contained in the cash flows from operational activities. No reason has been given by the Consultants of MSRDC for rejecting the indirect method invoked by KPMG, Chartered Accountants of REL/HDEC in their letter dated 12.8.2005. The said method is known as "reconciliation method". In this case, as stated above, the only reason given by the Consultants of MSRDC to exclude REL/HDEC was the negative impact on the future cash flows on account of the provisioning for doubtful debts in the accounts of HDEC for the FY 2001. If future cash impact was the basis to exclude REL/HDEC, then the Consultants for MSRDC should have considered cash flow reporting methods, which includes Reconciliation Method. There is no question of difference of opinion or different views as far as the application of cash flow reporting, which also falls in AS 3. There is nothing to show whether indirect method has at all been considered by Crisil, particularly when KPMG had invoked that method. There is no reason given for rejecting it. Lastly, in the PQ document, the referral years were three years. The criteria was that there should be NCP of not less than Rs.200 crores. However, the opinion of the Consultants proceeds on the basis that if "add back" is allowed it may have future cash impact. In the evaluation process, the Consultants were entitled to take into account future cash impact but in order to do so they had to say why the indirect method of "cash flow reporting" should not be accepted and if at all the impact of the provisioning was to be seen then there was no reason for not examining the audited accounts of 2004. There is a mix- up of two concepts here. The concept of non-compliance of financial criteria and the impact in future years on cash flow. As stated above, the very purpose of "cash flow reporting" is to find out the ability of HDEC to generate cash flow in future and if an important method of cash flow reporting is kept out, without any reason, then the decision to exclude REL/HDEC, is arbitrary, whimsical and unreasonable. In our view, for non- consideration of the Reconciliation Method, under cash flow reporting system, the impugned decision-making process stood vitiated.

36. In the result, we set aside the impugned judgment of the High Court; we hold that REL/HDEC (Consortium) was erroneously excluded from the second stage of bidding process. Accordingly, we allow this civil appeal with no order as to costs.

37. Since we have allowed this civil appeal, we extend the period for presenting financial bids by REL/HDEC up to 15.12.2007.