

**CHAPTER – V**  
**REVIEW OF INTERNAL CONTROL SYSTEM**

**5.1 Internal Control System in Textile and Handicraft Department**

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**CHAPTER - V**
**INTERNAL CONTROL SYSTEM****TEXTILE AND HANDICRAFTS DEPARTMENT****5.1 Internal Control Mechanism in Textile and Handicraft Department**

Internal controls provide the management with a reasonable assurance that the organization's objectives are being achieved and the organization is functioning in an economical, efficient and effective manner. A built-in internal control mechanism ensures the organization's adherence to the statutes, codes, manuals and departmental orders which minimize the risk of errors and irregularities and help the organization to protect its resources against losses due to negligence, abuse and mismanagement. Audit review of the functioning of the internal control mechanism during the period of 2003-08 in the Textile and Handicrafts (T&H) Department of Government of Arunachal Pradesh revealed deficient budgetary, financial, operational and administrative controls.

**Highlights**

- **The expenditure during the month of March was much higher than the expenditure incurred during the first quarter of the respective year and was as high as 76 per cent of the total expenditure of the Department during 2007-08**

**(Paragraph 5.1.7.4)**

- **The Director, T&H drew Rs. 1.17 crore in March 2008 and kept the entire amount in Deposit at Call Receipt.**

**(Paragraph 5.1.7.5)**

- **The utilisation of training capacity during the period 2005-08 ranged between 31 and 43 per cent.**

**(Paragraph 5.1.9.1)****5.1.1 Introduction**

The T&H Department was established on the bifurcation from the Department of the Industries Department in 1999-2000. The Department looks after the handloom, handicraft and sericulture activities in the State to preserve and promote the rich heritage of handloom, handicrafts, art and crafts by encouraging cottage and village industries and by setting up craft training centres to impart skills to the local youth to encourage self-employment and engage them in productive activities.

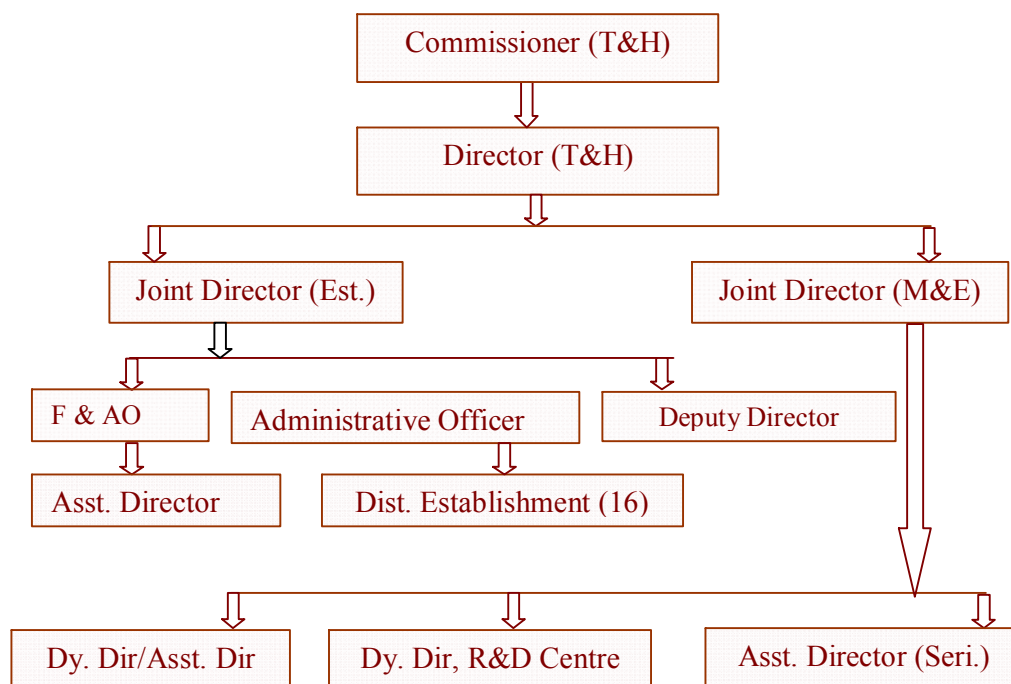
Since inception, the Department has taken up a number of remunerative schemes relating to socio-economic development and rural employment generation in the following sectors:

- Handloom Industries
- Handicrafts Industries
- Sericulture Industries
- Khadi & Village Industries
- Other Village Industries, and
- Bamboo Industries

### 5.1.2 Organizational Setup

The Commissioner, Textile and Handicrafts (T&H), is the administrative head of the Department. The Director is the head of the Directorate and he is assisted by two Joint Directors, FAO, Administrative Officer and one Deputy Director and 16 Deputy Directors/ Assistant Director in the formulation and implementation of various activities of the organization as depicted in the following organogram:

**Chart: 5.1**



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### **5.1.3 Scope of Audit**

Adequacy and effectiveness of the internal control mechanism in the T&H Department during the period 2003-08 was reviewed in audit through a test check (June-September 2008) of the records of the Directorate and five out of 16 District units viz. Papum Pare, (the capital district), Pasighat, Tezu, Changlang and Ziro (including sales Emporia at Itanagar).

### **5.1.4 Audit Objectives**

The objectives of the review were to examine and assess the adequacy and effectiveness of internal control mechanism in the Department, particularly with regard to the following aspects:

- Budgetary and Financial controls
- Administrative controls
- Operational controls
- Monitoring & Supervisory controls; and
- Internal Audit

### **5.1.5 Audit criteria**

The audit findings were benchmarked against the following criteria:

- Provisions of the General Financial Rules;
- Departmental policies/rules and regulations;
- Government notifications/guidelines issued from time to time; and
- Procedures prescribed for monitoring and evaluation.

### **5.1.6 Audit methodology**

Before taking up the review, an entry conference was held (30 June 2008) with the Director and other officials of the Department, wherein, the audit objectives, scope and criteria were explained. The audit findings were discussed with the Director and his officers in an exit conference on 17 November 2008 and their replies have been incorporated in the review, where appropriate.

### **5.1.7 Audit findings**

#### **5.1.7.1 Budget provision vis-à-vis expenditure**

Budget provision and expenditure incurred thereagainst by the Department during the period 2003-08 were as under:-

**Table: 5.1.1**

(Rs. in crore)

Year	Budget provisions			Expenditure			Excess(+)/ Saving(-) (Per cent)	
	Plan	Non-Plan	Total	Plan	Non-Plan	Total	Plan	Non-Plan
2003-04	5.73	4.57	10.30	5.44	4.31	9.75	- 0.29(5)	- 0.26(6)
2004-05	3.90	4.93	8.83	3.83	4.94	8.77	- 0.07(2)	-
2005-06	5.95	5.25	11.20	6.01	5.25	11.26	+ 0.06(1)	-
2006-07	5.36	6.10	11.46	5.65	6.10	11.75	+ 0.29(5)	-
2007-08	9.23	6.34	15.57	8.91	6.30	15.21	- 0.32(3)	- 0.04(1)
<b>Total</b>	<b>30.17</b>	<b>27.19</b>	<b>57.36</b>	<b>29.84</b>	<b>26.90</b>	<b>56.74</b>	<b>0.33(1)</b>	<b>-</b>

Source: T&H Secretariat

It may be seen from the above table, that the excesses and savings of the Department during the review period were marginal.

The Department stated (November 2008) that the budgeting and approval process in the State is very lengthy and the final approval of the Annual Operating Plan (AOP) is normally received in the month of November/December and sometimes even in the month of February. Consequently, the organization has very less time to implement AOP resulting in savings and excesses.

#### 5.1.7.2 Excessive budgeting for stipends to trainees

Budget allocation should be decided on the basis of the estimated fund requirement of any unit so that excesses and savings could be avoided. Further, budgetary requirement is normally calculated on the basis of expenditure during the previous years and the volume of the proposed activities during the year being budgeted for.

The year-wise budget provisions during 2003-04 to 2007-08 made for the disbursement of stipend under Handicraft Sector and expenditure incurred thereagainst are tabulated below:

**Table: 5.1.2**

(Rs.in lakh)

Year	No. of seats		Budget provision	Actual Expenditure	Savings (per cent)
	Available	Utilised			
2003-04	886	276	67.50	18.22	(-)49.28(73)
2004-05	886	298	51.17	19.67	(-)31.50(62)
2005-06	886	299	53.17	19.73	(-)33.44(63)
2006-07	886	381	51.35	25.15	(-)26.20(51)
2007-08	886	344	53.60	22.70	(-)30.90(58)

Source: T&H Directorate

Even though the actual intake of trainees year after year was far less than the maximum capacity, the Department continued to make excessive allocation,

having no relation to actual requirement of funds, which led to huge savings each year during 2003-08. This reflects on poor budgetary exercise in the department.

The Department admitted (November 2008) the audit finding and promised suitable action in the future.

### 5.1.7.3 Expenditure Control

The Director, H&T as Head of the Department is responsible for the budget allocation and to ensure that the activities in the Department are carried out efficiently and timely as planned. For this purpose, the monthly expenditure statements are to be sent by the DDOs to the Directorate as a part of the management information system (MIS) and internal control mechanism. This would help the controlling officer and other higher management in assessing on monthly basis the progress in the implementation of the planned activities, and to timely intervene whenever required.

The Department has no system of furnishing the monthly expenditure statements to the Directorate. In the absence of monthly expenditure statements the Directorate was not in a position to monitor the progress in the implementation of the planned activities by the field units and take timely action.

### 5.1.7.4 Persistent rush of expenditure in March

As per the General Financial Rules and Union Ministry of Finance's advice (September 2007), expenditure should be evenly phased over the financial year and the expenditure which can be incurred in the last quarter should not exceed 33 *per cent* of the total allocation. The rush of the expenditure at the close of the year may lead to infructuous, nugatory or ill-planned expenditure

The comparative position of the expenditure figures of the Directorate during the first quarter and March during the financial years from 2003-08, is tabulated below:-

**Table: 5.1.3**

(Rs. in crore)

Year	Total expenditure	Expenditure during first Quarter		Expenditure during March	
		Amount	Percentage	Amount	Percentage
2003-04	2.84	0.65	23	0.81	29
2004-05	4.18	1.01	24	1.00	24
2005-06	5.94	0.46	8	2.16	36
2006-07	5.51	1.30	24	1.90	34
2007-08	6.50	0.26	4	4.91	76

Source: - Directorate, T&H.

As can be seen from the above table, the expenditure incurred in the first quarter during the review period was always lower than the expenditure incurred in the month of March of the respective financial year. The position was more serious in 2007-08 when 76 *per cent* of the total expenditure was incurred in the month of March. However, no rush of expenditure was noticed in the test-checked districts.

The Department stated (November 2008) that due to the lengthy budgeting and approval process, little time was available for the implementation of the schemes. The reply is not acceptable as the reasons given for the March rush were all within the control of the Government and could have been adequately addressed.

As per the existing system in Arunachal Pradesh, funds released by the GOI for various Central/Centrally Sponsored Schemes are received first by the Finance Department (FD). Based on the requirement of funds projected by the Department in its annual operating plan (AOP) funds are released by the Finance Department. Scrutiny revealed that the approval of FD to the AOP normally takes abnormal time and consequently, delays the implementation of the targeted programme. Thus, there is an urgent need to streamline the existing procedure to obviate delays in transmission of funds so that the Department could utilise the funds in a planned manner on the approved activities.

#### **5.1.7.5 Drawal of funds without immediate requirement**

As per Receipts and Payments Rules, funds should be drawn only for immediate disbursement. Scrutiny of records revealed that the Director, T&H drew Rs.1.17 crore in March 2008 and kept the entire amount in the form of Deposit at Call Receipt (DCR). Even after a period of more than six months Rs.45 lakh of this amount was still being kept in DCR. The amount was sanctioned by the GOI in February 2008 for implementation of the Centrally Sponsored Scheme “Handloom Development Scheme” in the State.

Thus it appears that the amount was drawn in March 2008 mainly to avoid the lapse of the budget provision. This had the implication of booking expenditure against the grant concerned and inflating the financial progress of the activity without any actual physical progress. The probability of misuse, mis-utilization and even misappropriation of such funds drawn in advance and kept outside the accounts, cannot be ruled out.

The Department stated (November 2008) that since the fund was released at the fag end of March by the Government, there was no alternative with the T&H Directorate but to draw it and keep the money in DCR. Further, since it was a new scheme, a number of formalities were required to be observed before implementing it. The Department should approach the Government to simplify the existing procedure for release of funds so that the developmental

programmes are implemented on time and in compliance with the prescribed procedures.

#### **5.1.7.6 Non-reconciliation of drawal and deposit with treasury**

Drawing and disbursing officers are required to carryout monthly reconciliation of drawals and deposits with the records of the treasury by 10<sup>th</sup> of the following month, to ensure that the no drawal and deposit is left unaccounted,

Scrutiny of records of the Director (T&H) revealed that the prescribed monthly reconciliation with the treasury had not been done since the creation of the Department. As a result, possible non-accountal of remittances into treasury remains undetected.

The Department accepted the audit finding and stated that (November 2008) the required procedure would be followed in future.

#### **5.1.7.7 Non-reconciliation of expenditure figures with AG**

Reconciliation of departmentally compiled expenditure with those booked by the Accountant General (AG) is to be carried out every quarter. Such reconciliation provides assurance to the controlling office that the departmental accounts rendered by subordinate offices are a correct depiction of drawals from treasury and is a key control against fraudulent drawals. Scrutiny of records, however, revealed that the system of quarterly reconciliation did not prevail in the Department during the period 2002-08.

The Department accepted the audit finding and stated that (November 2008) the required procedure would be followed in future.

### **5.1.8 Operational Controls**

#### **5.1.8.1 Irregular Financial Transactions**

As per Rule 290 of Central Treasury Rules all payments exceeding Rs. 1000 should be made through cheque or bank draft instead of by cash. Scrutiny of Cash Book along with the Actual Payee's Receipts (APRs) revealed that the Directorate made total payment of Rs. 34.75 lakh in March 2008 to 55 local suppliers in cash when the transactions ranged between Rs. 13,570 to Rs. 5,94,165 in violation of the prescribed rules.

The Director, T & H stated (November 2008) that the Drawing & Disbursing Officer (DDO) was not empowered with the cheque drawing power. Further, he added that normally due to very late approval of Annual Operation Plan, the payments are accumulated in the last few months of the financial year and then the banks are not able to issue bank drafts due to rush of bills/transactions, and that the Department had no alternative but to draw funds in cash to make the disbursements within that financial year.



The very fact that the DDO did not have the cheque drawing power reflected on the poor operational control in the Department. It is pertinent to mention here that the problem was further aggravated as a result of the poor control over expenditure which allowed accumulation of expenditure at the end of the financial year compounded by late approval of the AOP.

#### **5.1.8.2 Lack of monitoring in distribution of CGI sheets**

Scrutiny of records of Deputy Director (T&H), Lower Subansiri District revealed that the unit received (September 2005) 900 CGI Sheets (9 MT) valued Rs.3.99 lakh from a Guwahati based firm for distribution to the eligible sericulture beneficiaries at the rate of Rs. 5000 per beneficiary as assistance for construction of rearing houses under Vanya Silk Programme. Out of this, 315 sheets were transferred to the Deputy Director (T&H) of Kurang Kumei District in March 2006 and 497 sheets were stated to be issued to 18 beneficiaries between October 2005 and April 2008 and the remaining 88 sheets were lying idle till the date of audit (July 2008) without assigning any reasons. Scrutiny also revealed that material issued to each beneficiary ranged from 20 to 37 sheets worth Rs.8860 to Rs.16,391 was also not in conformity to the approved norm of Rs.5000 per beneficiary. The excess amount of CGI sheets issued and the abnormal time of three years taken by the Department in distribution to the eligible beneficiaries throw serious doubts about the effectiveness of the system in place to ensure that correct amount of assistance is extended in a timely manner to the right beneficiaries.

In reply, the Department stated (November 2008) that the balance quantity of 88 sheets were issued to three beneficiaries on 23 and 24 October 2008 due to delay in receipt of requisitions from the beneficiaries.

#### **5.1.8.3 Non-preparation of Department Manual**

The Department should have its own Manual prescribing the processes and procedures for running various activities. Manual should be updated and revised periodically to ensure that it carries the new instructions and guidelines. Scrutiny revealed that T&H Department does not have its own manual.

In reply, the Department stated that they are following GFR and the important Government orders are maintained in a guard file. Department is advised to consolidate the standing important orders and compile its own manual and ensure that the copies are made available to the filed units for their use.

#### **5.1.8.4 Unproductive expenditure due to idle assets**

- In 1996, the Department acquired an industrial shed with a covered area of 1200 sqft at New Okhla Industrial Estate (Phase-II) in New Delhi at a cost of Rs.12.94 lakh for use as Handicrafts Development-

cum-Marketing Centre and renovated it at a cost of Rs. 7.84 lakh. In addition, incidental expenditure like property tax, water tax amounting to Rs. 4.39 lakh was spent up to March 2004. Any payment made on these account thereafter was not on record.

Scrutiny revealed that initially the Centre functioned with some contingent artisans to manufacture cane and bamboo items. However, since 1999-2000 no production and other development activities were carried out, as the artisans left the Centre due to poor accommodation facilities and irregular supply of raw material. Thus, the failure of the Department to ensure proper supply of raw material and proper maintenance of the accommodation resulted in unfruitful expenditure of Rs.25.17 lakh which is indicative of poor operation controls.

The Department stated (November 2008) that the asset could not be put to any productive use due to shortage of funds, and that efforts are being made to rent it out to the highest private bidder.

- The Department paid Rs.15 lakh to the Public Works Department (PWD) for construction of a semi-permanent building to be used as the new training centre at Riga, East Siang District. Though the newly constructed building was handed over to the Department by PWD in November 2005 it was not utilised even after the lapse of three years of its acquisition (October 2008). Reasons for non-utilisation of the asset were not on record. Non-utilisation of the asset created at a cost of Rs. 15 lakh even after a lapse of nearly three years is indicative of lack of proper planning.

The Director (T&H) accepted the audit findings and stated (November 2008) that he has already asked his District Officer to use the building for some constructive purpose.

#### **5.1.8.5 Underutilized training infrastructure**

In respect of Sericulture and Handloom Industries, the targets for imparting training to the local youth under High Skilled Development Programme (HSDP) are fixed annually.

- The number of persons to be trained under HSDP in Handloom sector was fixed at 260 each year. It was found in audit that against these targets, not even a single person was trained during 2003-08.
- Similarly, against the annual target of training 600 persons in Sericulture Sector during the years 2003-06, none was found to be trained. Department then downscaled the annual targets to 141 and 100 for 2006-07 and 2007-08 respectively. Against these, the achievement was 141 and 20 during 2006-07 and 2007-08 respectively.

The Director stated (November 2008) that the reason for underutilisation of the training infrastructure was the paucity of funds and the position would improve when funds are made available.

The Department should have fixed annual targets taking into account availability of funds during the year rather than as a matter of routine. Further, it is indicative of the Department's failure to mobilise adequate financial resources required for imparting training so that the optimal utilisation of the training infrastructure is ensured to improve the skill and earning potential of the trained youth.

#### **5.1.8.6 Non- maintenance/improper maintenance of records**

##### ***Cash Book***

A review of the existing cash management system in the test checked districts revealed instances of non-compliance with the laid down instructions/procedures in the maintenance of Cash Book as detailed below:

**Table: 5.1.4**

	<b>Name of district units</b>	<b>Deficiencies in maintenance of Cash Book</b>
1.	Deputy./Assistant Director Yupia, Teju and Pasighat	Cash Book was not closed regularly and not authenticated
2.	Deputy./Assistant Director, Teju, Ziro, Changlang and Pasighat	Frequent cancellations and corrections in Cash Book without any authentication.
3.	Deputy./Assistant Director, Teju, Pasighat and Daimukh	The month-end physical cash verifications were not carried out.

The Director, T&H accepted (November 2008) the audit findings on maintenance of Cash Book and assured that efforts would be made to streamline the system in the Department.

##### ***Asset Register***

Similarly, the Department is required to maintain an Asset Register for recording the details about the assets created/acquired or received from any other source. The register helps in keeping the accountal, monetary value, movement and history of the assets. Scrutiny of records revealed that in the Directorate as well as in five test-checked districts, no asset register was maintained.

The Director admitted (November 2008) the audit finding and promised that the requisite registers would be maintained henceforth.

## 5.1.9 Administrative Control

### 5.1.9.1 Shortfall in training

Handicraft training is one of the important factors in ensuring efficient manpower development for activities relating to the carpet weaving, cane furniture, wood turning, beaded ornaments, carpentry, etc. The training activity is closely linked to one of the objectives of the Department - ‘to preserve and promote the rich heritage of handloom, handicrafts, art and crafts by encouraging cottage and village industries and by setting up craft training centres and thereby imparting skills to the local youth in different trades’.

In paragraph 5.1.7.2, the fact regarding excessive provisioning of funds to cater to stipend for trainees undergoing handicraft training has been pointed out. There are 886 seats in 88 training centres in the State offering various courses in the Handicraft Sector. The Department has employed 24 Craft Superintendents, 115 Craft Inspectors and 106 Craftsman to impart skills to the trainees in different trades. The utilisation of training capacity available vis-a-vis the actual enrolment and the training results during the years from 2003--08 is captured in the following table:

**Table: 5.1.5**

Year	Training capacity	Enrolled trainees	Shortfall ( <i>per cent</i> )	No. of trainees passed	Percentage of	
					Pass	Fail
2003-04	886	276	610 (69)	192	70	30
2004-05	886	298	588 (66)	191	64	36
2005-06	886	299	587 (66)	171	57	43
2006-07	886	381	505 (57)	140	37	63
2007-08	886	344	542 (61)	113	33	67

*Source: Directorate (T & H)*

It is evident from the above table that the training infrastructure was not used optimally, as the annual average enrolment for the training during the period from 2003-08 was very poor and average capacity utilisation during the period was a mere 36 *per cent*. Further, the pass percentage showed a downward trend and declined from 70 *per cent* in 2003-04 to a mere 33 *per cent* in 2007-08. The wide gap between the training capacity and the actual utilisation thereof reflected upon the poor administrative procedures and is indicative of the Department’s inability to attract eligible candidates. This may be due to lack of awareness about the training facilities being offered by the Department. The Department had not analysed if the decline in pass percentage was due to wrong selection of trainees or due to lack of adequate faculty or poor-competence of the training faculty.

Further, as the capacity utilisation during 2005-08 ranged between 31 and 43 *per cent*, it is evident that all the courses being offered at these training centres might not have been conducted during the period. As such, the manpower positioned at these training centres was rendered idle. Thus, expenditure incurred on their salary, etc to a large extent was unproductive.

The Director stated (November 2008) that the Minister, T&H has already approved the lowering of the qualification for enrolment in the training programme, and this is expected to improve the utilisation of training infrastructure. While lowering the qualification can partly solve the problem of low utilization, this will also have a direct negative impact on the already poor pass percentage at the training centres.

#### **5.1.9.2 Physical Verification of Stock**

As per the General Financial Rules, physical verification of the stock needs to be done annually. Audit scrutiny revealed that the physical verification of stock was done (April 2008) in Itanagar S&T Emporium after a period of four and a half years. Due to the absence of an effective system of annual physical verification of stocks, the old unsold items in the Emporium could not be identified timely leading to higher discounts when finally detected. In this case, the management came to know about the old unsold handloom and handicraft items procured between 1993 and 2003 worth Rs. 5.25 lakh. The Emporium then allowed a rebate of 57 *per cent* on these old items.

Similarly, Doimukh Emporium conducted physical verification only twice (Feb-2005 & Mar-2008) during the last five years and had to allow rebate of 70 to 90 *per cent* on unsold handloom and textile items (worth Rs. 1.46 lakh). The absence of annual physical verification of stores and assets reflects on poor administrative controls in the Department.

In reply, the Department stated (November 2008) that physical verification could not be conducted annually due to the observance of various time consuming formalities relating to stocktaking. The practical difficulties pointed out by the Department in stocktaking are within their control and could be sorted out through suitable efforts. In the absence of regular periodical physical verification, the probability of loss/ misappropriation of stores cannot be ruled out.

#### **5.1.9.3 Departmental Inspections**

It is important that an organization has a system of departmental inspections to ascertain its compliance with statutory, regulatory, financial and operational requirements and controls. The system should specify the inspection requirements for different level of officers, their frequency and their nature i.e. surprise or informed and the reporting requirements. No such system was

prevalent in the T&H Department thereby depriving the organization of an effective layer of internal control.

#### **5.1.10 Internal Audit System**

Internal Audit (IA) is considered necessary to evaluate the efficiency and effectiveness of the internal controls and procedures in the organization. The Director of Audit and Pension, Arunachal Pradesh is responsible for conducting internal audits in the State Government departments including T&H Department. During the years 2003-08 neither the Director of Audit conducted any internal audits nor did the Department itself engage any other alternative agency for this purpose.

The Department (November 2008) stated that the internal audit is the responsibility of the Directorate of Audit and Pension. The Department should have impressed upon the Director of Audit and Pension the need to conduct periodical internal audit so that corrective measures based on their recommendations could be taken to improve the functioning of the Department or else the Department should have approached the government to make alternative arrangement, if Director of Audit and Pension was not in a position to carry out its mandate of internal audit.

#### **5.1.11 Conclusion**

As brought out in the foregoing paragraphs, many of the internal controls viz, budgetary and financial control, operational control, administrative control and internal audit system were either absent or inadequate/or ineffective in the T&H Department. Budget allocation was not realistic, Infrastructure created/acquired remained idle or underutilized, training activities were not effective, internal audit was absent, stores and assets were not physically verified, departmental inspection was missing and important records were not being maintained.

#### **5.1.12.1 Recommendations**

- Financial controls need to be strengthened to ensure that expenditure is evenly spread throughout the financial year, and required funds are provided for the necessary activities of the organisation.
- Operational controls should be made more efficient and effective to ensure that the assets are created strictly on need basis and the assets so acquired are put to use for the purpose they are acquired. Efforts should be made to optimally utilise the training infrastructure created.
- Management needs to give special attention to the Cash management system in the organization and strengthening the relevant controls.

- Physical verification of stock should be carried out at regular intervals as prescribed under the rules so that accumulation of old stock is avoided.
- The Department should reconcile their figures with the treasuries and AG office at prescribed intervals.
- The State Government should be approached to make alternate arrangement for internal audit of the Department, if the present arrangement fails to carry out the task.