

CHAPTER – VII
INTERNAL CONTROL AND INTERNAL AUDIT
FINANCE DEPARTMENT

7.1 Internal control/internal audit system

7.1.1 Introduction

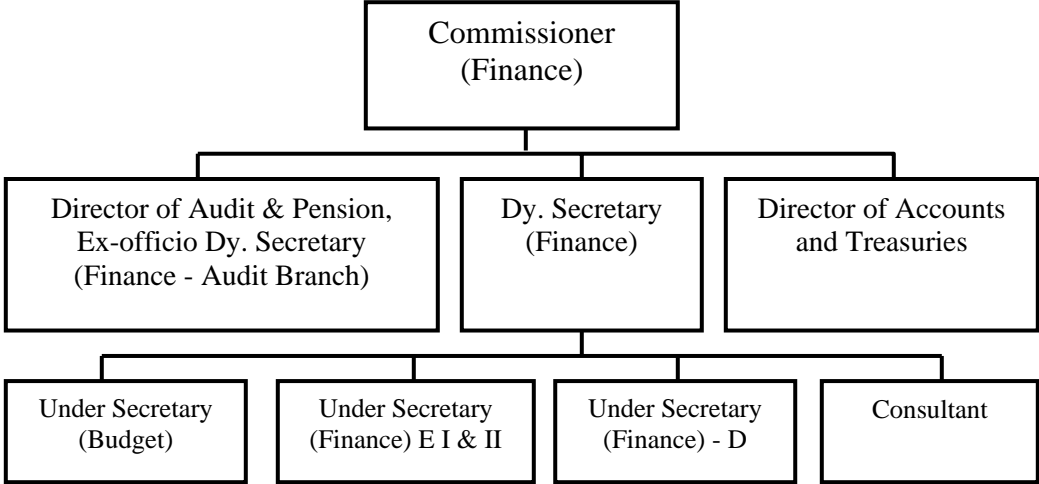
Internal Control is an integral process which is designed to provide reasonable assurance for achieving objectives viz., fulfilling accountability obligations, complying with applicable laws and regulations, executing orderly, ethical, economical, efficient and effective operations and safeguarding resources against loss. It is a dynamic integral process that is continuously adopting to the changes an organisation is facing. Management and personnel at all levels have to be involved in this process to provide reasonable assurance of the achievement of the objectives.

Internal Audit, on the other hand is an internal control mechanism that evaluates the efficiency and effectiveness of other types of internal controls. Internal Audit works as the ‘eyes and ears’ of higher management. Internal Audit is also an independent appraisal of the activities within the organisation for review of accounting, financial and other business practices and it works as a protective and constructive arm of the management.

7.1.2 Organisational set-up

The organisational set-up of the Finance department is depicted in the chart given below:

Chart – 7.1



7.1.3 Audit coverage

Test check of records maintained by the Finance Department (Budget, Establishment & Audit branch), Director of Accounts & Treasuries and Director of Audit & Pension was conducted in June 2004. Points noticed during audit are discussed in the succeeding paragraphs:

7.1.4 Structure of the Government

There are 43 heads of departments (HOD) under whom there are 633 drawing and disbursing officers (DDOs).

Failure of the internal control system

7.1.5 Budgeting and expenditure control

The Finance Department did not prepare any budget manual of their own and the provision of General Financial Rules is followed for formulation of budget and other financial matters. The Budget branch of the Finance Department prepares the budget which is scrutinised at the level of two Section Officers, one Under Secretary and Special Secretary (Finance), Commissioner (Finance). There is no mechanism in the Finance Department to ensure that the prescribed procedures are followed.

The Budget Branch of the Finance Department is entrusted with the responsibility of monitoring the expenditure incurred by the departments against the funds allocated. However, there is no separate cell under the budget branch for closely monitoring the expenditure. According to the existing system, controlling officers should submit the expenditure statement of a month by 15th of subsequent month. But it was noticed in audit that there were arrears in submission of monthly expenditure statements by the controlling officers. The existing system/mechanism for preparation of budget and control of expenditure is not adequate, as would be evident from the following deficiencies noticed in audit and reported from year to year in chapter II of the Audit Report:

- Excess expenditure over provisions.
- Cases of unnecessary/excessive supplementary provision.
- Cases of persistent excesses/savings.
- Cases of substantial savings/excesses.
- Cases of expenditure without provision of fund and re-appropriation.
- Cases of non-utilisation of entire budget provision (original and supplementary).

The above points indicate defective budgeting as well as ineffective internal control mechanism and calls for better monitoring and control by the Finance Department.

Rules provide that drawals in abstract contingent (AC) bill require submission of detailed countersigned contingent (DCC) bill. The position of unadjusted AC bills had been reported year to year in chapter II of the Audit Report. It was, however, noticed (June 2004) in audit that the Finance Department did not maintain any record regarding unadjusted AC bills to ensure timely submission of DCC bills. During the period from March 1999 to March 2001, 18 drawing and disbursing officers drew Rs.1.97 crore through 35 AC bills but DCC bills for the same had not been submitted as of June 2004. These drawals remained unadjusted for the period of three to five years. This indicates serious deficiency in control over expenditure.

7.1.6 Functioning of Directorate of Accounts and Treasuries

In June 1999, two separate Directorates *viz.*, Director of Accounts and Treasuries, and Directorate of Audit and Pensions were created from the existing Directorate of Accounts and Treasuries, for effective administrative control and proper financial management. The Director of Accounts and Treasuries deals with the Finance and Accounts Service Establishment, General Provident Fund, Treasury Administration of the State and Loans and Advances to State Government employees.

7.1.7 Pending cases of General Provident Fund final payment

During the period 2001-02 to 2003-04 the DAT, Naharlagun finalised 1617 cases of General Provident Fund (GPF) final payments, while 430 cases (2001-02: 95; 2002-03: 126; and 2003-04: 209) remained pending till the date of Audit (June 2004). The DAT stated (June 2004) that the cases remained pending due to shortage of staff. However, information furnished (June 2004) to audit did not indicate the shortage of staff with reference to sanctioned strength. Action, if any, initiated to clear the pending cases has also not been reported. The pending cases of GPF final payments indicate lack of effective administrative control and financial management.

Further, for the purpose of GPF final payments, the Directorate has a final payment section with two dealing hands under the supervision of one branch superintendent and the cases are routed through the Finance and Accounts Officer of the Directorate to the Director who is the final authority. Apart from this normal process of finalisation of GPF final payments, there was no other independent control mechanism existing in the Directorate to review final payments and hence the possibility of error could not be ruled out.

7.1.8 Lack of planning

The Annual Plan of the State Government is the main operational instrument for the Five Year Plan. On the basis of available financial resources the departments are to ensure fund provision for spill over schemes. Mention was also made in para 4.1.4 (c) of the Report of the Comptroller and Auditor General of India for the year ended 31 March 2000 regarding taking up new works every year by the Public Works Department without providing adequate

funds for the ongoing projects. It was seen in audit that the practice of taking up of new works without ensuring adequate funds for completion of ongoing projects still continued. There were 1276 ongoing roads and bridges works as of 2003–04 and the funds required for completion of these works were Rs.131.63 crore. Against this, a total amount of Rs.24.60 crore was provided for the year 2003-04, which was only 19 *per cent* of funds required for completion. However, during the year 2003-04, 526 new works of roads and bridges were taken up for which funds amounting to Rs.27.15 crore had been provided. Taking up of new works, instead of completing the spill over/ongoing works would lead to delay in completion of the works resulting in cost overrun. This indicates that the Finance Department lacks control over providing funds to the Public Works Department.

7.1.9 Internal Audit system

In June 1999, a separate Directorate *viz.*, Directorate of Audit and Pensions was created entrusting, *inter alia*, the responsibility of internal audit in the State. The Directorate, however, did not evolve any internal audit system of their own and continued to follow the system that came into existence during the North East Frontier Agency administration.

7.1.10 Man power

For effective and comprehensive Internal Audit, adequate manpower with right skills is a prerequisite. The men-in-position for internal audit as of June 2004 against sanctioned strength and their deployment are as under:

Table - 7.1

Posts	Sanctioned strength	Men-in-position	Deployment
Assistant Audit officer (AAO)	22	22	12 AAOs posted in 11 districts (under Deputy Commissioners), nine in Directorate and one in State Transport Services, Naharlagun.
Assistant Auditor (AA)	15	8	Six AAs posted in six districts (under Deputy Commissioners) and two in Directorate.

The available staff *i.e.*, 22 AAOs and eight AAs are not sufficient to conduct the effective audit of 633 auditee units/DDOs offices. This aspect should have been viewed in the light of Internal Audit's jurisdiction that extends over all the Government departments, offices under 43 HODs.

During the years 2001-04, the Director of Audit & Pensions had conducted audit of only 41 units. As regards local audit conducted by the staff posted in DC's office/field offices, no information was available with the Directorate. The Director stated (June 2004) that these records are maintained by the Audit Branch of Finance Secretariat. However, the Audit Branch of Finance Secretariat failed to furnish the details of audit conducted by the DCs/other offices through the field auditors posted to their establishment, as no such

records were maintained in the Secretariat. This clearly indicates that the internal audit system prevailing in the State is inadequate and ineffective.

7.1.11 Independence of internal audit

It is important that the functional and financial independence of auditors is maintained for an effective internal audit system so that it is able to take decisions regarding its audit activities on merit basis. It should report to and work under the direct control of the head of the organisation. Functional independence also ensures that the internal audit acts as the ‘eyes and ears’ of the organisation, especially of the head of the organisation.

Though a separate Directorate was created in June 1999 for the purpose of internal audit, the DCs at the district level offices conducted audit through AAOs/AAs posted in the DC’s establishment without any approval from the head of the organisation. The DCs act as reporting officer and monitor the performance of the AAOs/AAs. Thus, in absence of independent functioning of the AAOs/AAs, the effective internal audit system cannot be ensured and independence of the staff of the Director of Audit & Pensions is compromised.

7.1.12 Audit standards and audit manual

To ensure that the quality of audit is not compromised or substandard, auditing organisations frame their own auditing standards or adopt some accepted auditing standards. The work done by the auditors should continuously be in conformity with the adopted standards.

It was noticed in audit that the Directorate had neither framed nor adopted any auditing standard and no internal audit manual had been brought out by the Directorate/Government. In the absence of any Auditing Standards/Audit Manual, the quality of work done remained unevaluated.

7.1.13 Audit planning

It is an accepted fact that for efficient and optimum utilisation of the limited manpower and financial resources, audit planning is required to be done every year. This ensures coverage of all required units over a period of time, prioritisation of auditee organisations in audit according to need, finalisation of time schedule for audit, distribution of audit resources among various types of audit, *etc.* Audit planning includes creating financial and functional profile of the auditee organisations, capturing their main activities in terms of finance and objective of the department, identifying important sources of revenue, assessment and distribution of audit manpower, *etc.* The audit plan leads to formation of an annual calendar of audit that contains targets in terms of number of offices to be audited, time schedule, *etc.*

It was noticed that the concept of audit planning is not prevalent either at the Directorate or at district level. No target in terms of number of units to be audited, financial value of audit observations, *etc.*, were fixed. Audit is

conducted only when a request is received by the Directorate or is desired by the DCs concerned.

7.1.14 Reporting, issuance and follow up action of Inspection Reports

In a well established internal audit system, follow up action on the Inspection Reports (IRs) is a necessity as this ensures an effective internal audit and the Government benefits from these observations through corrective and preventive measures.

Though a separate Directorate was created in June 1999 entrusting the responsibility of internal audit, the prevailing system of conducting audit both by the Directorate as well as DCs at the district level still continued. The Director of audit stated (June 2004) that after completion of audit the IRs in respect of audit conducted from Directorate and also from district level are sent to Audit Branch of the Finance Secretariat. The Audit Branch was responsible for issue of IRs within 15 days from the date of completion of audit as well as for further follow up action on the IRs. But, it was noticed that in the Audit Branch no record indicating the number of units audited during a year, IRs received and issued, total number of IRs and paras settled and outstanding, progress register and objection book of outstanding IRs/paras, monthly/quarterly report on settlement of paras were maintained. As a result, delay if any, in issue of IRs, position of outstanding IRs, *etc.*, could not be verified in audit. The Audit Branch of the Finance Secretariat deals mostly with the Audit Reports and IRs/paras received from Accountant General (Audit). This indicated that there was no follow up action/pursuance and monitoring of the IRs either at the Directorate or at the Audit Branch. This frustrated the very purpose of internal audit.

7.1.15 Lack of training

Staff training is one of the important aspects of Human Resource Planning and Development. The job of audit being technical, the audit staffs are required to be kept updated to improve the quality of audit adopting new auditing techniques particularly with the introduction of new technologies *i.e.*, information technology in auditee organisation through periodical training programme. It was, however, noticed that internal auditors were imparted training only once on accounts for six months by the Administrative Training Institute, Naharlagun. No other training for improvement of the quality of the audit, adoption of new audit techniques, refresher courses, *etc.*, was imparted to the audit staffs. Two out of 22 Assistant Audit Officers were not imparted any training at all.

7.1.16 Recommendations

The internal control/internal audit system in the State needs to be revamped to achieve its desired objectives. Its control and independence is to be ensured, work has to be planned, requisite manpower needs to be provided, reporting

and monitoring system needs to be strengthened and ensured so that it can work as a better control tool that evaluates and reports on the efficiency and effectiveness of the functioning of the various Government departments.

The foregoing points were reported to Government in August 2004; reply had not been received (October 2004).

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