

INTERNAL CONTROL/INTERNAL AUDIT

CO-OPERATION DEPARTMENT

5.1 *Internal Control System in Co-operation Department*

Highlights

Internal controls provide the management with a reasonable assurance that the organisation's objectives are being achieved and the entity is functioning in an economical, efficient and effective manner. A built-in internal control system and adherence to the statutes, codes, manuals and departmental orders minimise the risk of errors and irregularities and help to protect organizational resources against loss due to wastage, abuse and mismanagement. Audit review of the functioning of the internal control mechanism during 2002-03 to 2006-07 in the Co-operation Department revealed deficient budgetary, financial, operational and administrative controls and deficiency in internal audit system in the Department.

Irregular and unrealistic budget formulation and lack of budgetary control resulted in substantial savings of Rs.87.21 crore during 2002-07.

(Paragraphs-5.1.8 and 5.1.9)

There were 360 cases of misappropriation, fraud and embezzlement of funds amounting to Rs.1.79 crore in the societies.

(Paragraph-5.1.23)

Only an amount of Rs.0.23 crore was recovered against outstanding loan of Rs.50.30 crore during 2002-07.

(Paragraph-5.1.24)

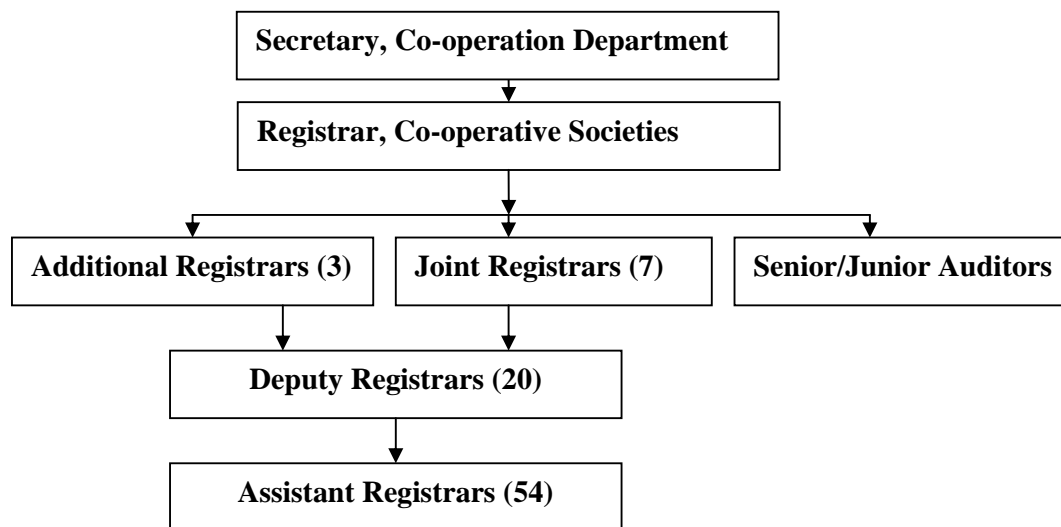
5.1.1 *Introduction.*

Internal control is a management tool that is used to provide reasonable assurance that the organisation's objectives are achieved in an efficient, effective and adequate manner. It ensures that the financial interests and resources of the organisation are safeguarded, reliable information is available to the management and the activities of the entity comply with the applicable rules, regulations and laws. The Co-operation Department plays a vital role in implementation of Co-operative movement in the State. The main function of the Co-operation Department is to promote Co-operative societies in the State. As of March 2006, there were 10,134 registered societies in the State. The position has not been updated as of March 2007 by the Department.

5.1.2 *Organisational set up*

The Secretary is the administrative head of the Department of Co-operation at the Government level. Registrar of Co-operative Societies, Assam (RCS) is the head of the Department. The organizational structure of the Department is shown in Chart-1 below:

Chart-1



5.1.3 *Scope of Audit*

The evaluation of the internal control mechanism in the Co-operation Department was carried out during April and May 2007 for the period 2002-03 to 2006-07.

5.1.4 *Audit Objectives*

Audit objectives were to examine and assess the adequacy and effectiveness of the internal controls in the Department, particularly in respect of the following aspects:-

- Budgetary Control
- Financial Control
- Administrative Control
- Operational Control
- Internal Audit System
- Supervisory control and monitoring

5.1.5 *Audit Criteria*

The audit objectives were benchmarked against the following criteria: -

- Assam Financial Rules;
- Budget Manual of the Government of Assam;
- Assam Co-operative Societies Act 1949;
- Departmental policies/Rules and regulations;
- Government notifications/guidelines issued from time to time;
- Procedures prescribed for monitoring and evaluation.

5.1.6 *Audit Methodology*

Before taking up the review, an entry conference was held in April 2007 with the Registrar and other Officers of the Department wherein the audit objectives, scope and criteria were discussed. Records of RCS, Guwahati and four other Offices viz. one Zonal Office (JRCS, Guwahati Zone) one District Office (DRCS), Kamrup and two Sub Divisional offices (Guwahati and Rangia) were test checked. An exit

conference was held in June 2007 wherein the audit findings were discussed with the Registrar. Replies of the Department have been incorporated in the review where appropriate.

5.1.7 *Audit Findings*

Audit of the internal control system revealed that apart from deficiencies in budgetary control, there were instances of unproductive expenditure, misappropriation of funds, non-recovery of loans etc., as detailed in the succeeding paragraphs.

Budgetary Control

5.1.8 *Unrealistic budget estimation and lack of budgetary control*

In terms of the provisions of the Budget Manual, the Estimating Officer is to scrutinise and consolidate the estimates obtained from the subordinate officers together with his own estimates, into a self-contained budget. It was, however, found that the annual budget estimates of the Department were prepared on the basis of the total outlay fixed by the Government without working out the requirement of the field offices except the salary component.

The annual budget of the Department prepared without inputs from the subordinate offices as stated above, proved excessive, resulting in substantial saving every year as shown in Table-1 below:

Table-1

(Rs in Crore)

Year	Budget Provision	Supplementary Grant obtained	Total Grant	Total expenditure	Saving (Percentage)
2002-03	49.52	18.09	67.61	35.68	31.93 (47)
2003-04	61.70	2.54	64.24	51.01	13.23 (21)
2004-05	80.95	0.10	81.05	61.90	19.15 (24)
2005-06	40.50	1.00	41.50	26.96	14.54 (35)
2006-07	34.88	1.61	36.49	28.13	8.36.(23)
Total	267.55	23.34	290.89	203.68	

Source: Appropriation Accounts

During 2002-07, as against the total budget provision of Rs.290.89 crore, only Rs.203.68 crore were spent. The savings ranged between 21 percent to 47 percent. Further obtaining of Supplementary Grant was not justified as the savings far exceeded the Supplementary Grant. This indicates that proper care was not given to preparation of budget. Further, there was no expenditure control or expenditure monitoring system as instead of surrenders, the Department obtained Supplementary Grants.

The Department stated (April 2007) that savings occurred due to transfer/retirement of staff and officers of the Department, and due to non-release of fund by the Central/State Governments under plan schemes. The fact remains that there were huge savings rendering the budget provision unrealistic.

5.1.9 *Non surrender of savings*

Timely surrender of savings is a key budget control measure so that funds can be appropriated for use by other Departments. According to the Budget Manual and also rules framed by the Government, the spending Departments are required to surrender

grants/appropriation or part thereof to the Finance Department as and when savings are anticipated latest by 15 March of the respective year.

Although the Department had huge savings every year, these were not surrendered on time except for Rs.27.25 crore during 2004-05 and Rs.4.80 crore in 2005-07. The surrenders in 2002-03, 2003-04 and 2005-06 were done on the last day of the financial year during re-allocation to other priority areas that required funds. It was also seen that during 2004-05, surrender of Rs.27.25 crore was far in excess of savings of Rs.19.15 crore. Non-surrender of savings within the stipulated date and excess surrender indicates poor budgetary control by of the Department.

Financial Control

5.1.10 Deficiencies in expenditure control

Expenditure Control is the responsibility of the Controlling Officer (Registrar). The budget allocation is apportioned among the DDOs by the Controlling Officer by issuing Letter of Credit (LOC)/Fixation of Ceiling (FOC) to the DDOs and the treasury concerned. The expenditure incurred by the DDOs is monitored through the monthly expenditure statements compiled in a register maintained for the purpose.

Para 137 of the Budget Manual provides that the DDOs should send the monthly expenditure statements to the Controlling Officer by the 3rd of the following month.

It was observed that the DDOs were irregular in sending monthly expenditure statement e.g., 43 out of 62 DDOs of the Department did not submit the monthly expenditure statement from October 2005 to October 2006. As the monthly expenditure statements from all the DDOs were not received on time, the compilation of expenditure in the office of the RCS was done excluding the expenditure incurred by the defaulting DDOs. Thus, the accounts did not depict the total monthly/yearly expenditure of the Department and was not comprehensive.

Thus, a significant accountability mechanism of expenditure control was deficient in the Department.

5.1.11 Absence of reconciliation of departmental expenditure

To enable departmental officers to exercise proper control over expenditure, there are standing instructions from the Government to reconcile the departmental figures with those recorded in the books of the Accountant General (A&E) monthly/quarterly. Records revealed that the Department did not carry out any reconciliation during the review period, disregarding the provisions of Assam Financial Rules (AFRs).

5.1.12 Deficiencies in maintenance of Cash Book

Mandatory checks required to be excised under Rule 95 of AFRs relating to the maintenance of Cash Book were lacking in all the five offices test checked. The following deficiencies were noticed in the Cash Book during the course of audit:

- Individual entries of receipt and payments were not attested by the DDOs.
- Surprise physical verification was never done by the Head of the Office or by an officer nominated for this purpose other than the DDO to ascertain the authenticity of the closing balances.
- Analysis of the closing cash balance at the end of each month was not done in three out of five offices test checked viz. JRCS, Guwahati, DRCS, Kamrup and ARCS, Guwahati.

- Physical verification of cash was not done and a certificate to that effect was not recorded at the end of each month.

Failure to exercise the regulatory checks in cash management indicates serious lapses in internal control system and thus, is fraught with the risk of misappropriation of Government money.

5.1.13 Non reconciliation of drawal and deposits

As per the instructions of the Finance Department the DDOs are required to carry out monthly reconciliation of drawals and deposits with the records of the treasury by 10th of the following month. Test check of records of five offices revealed the prescribed monthly reconciliation with the treasury was not done. In the absence of this check, non-accountal of remittances into treasury or forged drawals if any, from treasury would remain undetected.

5.1.14 Unfruitful expenditure

The RCS released grants-in aid of Rs.40.34 lakh during 2002-07 to the Assam Co-operative Training Institute, Joysagar, a society set up to organise training courses for the officers and staff of the Department. The grant-in-aid was to meet the establishment cost including pay and allowances of the staff of the Institute.

The Institute could not conduct any training during the last five years as it was occupied by CRPF personnel. Reasons and authority for occupation of the building by CRPF personnel were not stated to audit.

Since the Institute remained non-functional, its staff (one Gr. III and three Gr. IV employees) were attached to the office of the Deputy Registrar, Co-operative, Sibsagar, but the expenditure of Rs.40.34 lakh on account of their pay and allowances during the period were met out of the grant-in aid. Thus, the purpose for which the grant-in aid was released got frustrated.

The Department did not take any action for vacation of the institute building occupied by the CRPF personnel.

5.1.15 Non maintenance of control registers

Various Registers like registers of revenue deposit, Deposit at Call Receipts, Bank Drafts, Banker cheques register, advance/recovery register, undisbursed pay and allowances register, Letter of credit/Fixation of ceiling register, and broad sheets for loans and advances were not maintained by the ARCS, Rangia resulting in inadequacy in maintenance of basic records.

5.1.16 Non verification of entries by DDO

In the office of the Assistant Registrars, Guwahati and Rangia the entries in the register relating to recovery of loans and interest were not found attested by the DDOs. Thus, authenticity of figures of outstanding loans and interest could not be ensured.

Administrative Control

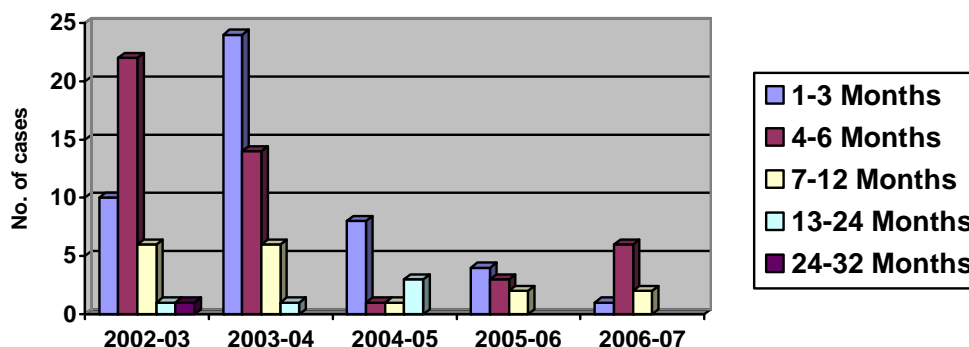
5.1.17 Delay in disposal of pension cases

According to the Assam Pension Rules, 1969 pension papers should be processed on time so that the pensioners begin to receive pensionary entitlements from the day on which these become due. As per norms, pension papers should be sent to the Office of

the Accountant General (A&E) six months ahead of the date of retirement of an employee.

Scrutiny of 116 pension cases for the period from 2002-03 to 2006-07 revealed that there were delays in forwarding the pension papers to the office of the Accountant General (A&E) for periods ranging from 1 to 32 months from the date of retirement as shown in Chart-2 below:

Chart-2
Forwarding of Pension Papers to AG (A&E)



Further, 13 cases of employees who have retired during October 2004 to March 2007 had not been forwarded to A.G (A&E) as of May 2007. Reasons for delay in forwarding the pension papers were neither on record nor stated to audit.

The above position indicates laxity in supervisory controls.

5.1.18 Non-obtaining of security deposit

As per Rule 106 of AFR every Government servant, who is entrusted with the custody of cash or stores shall be required to deposit security for such amount as the Department may prescribe. Test check of records of the five DDOs revealed that no security had been obtained from any of the cashiers dealing with Government cash. Thus, the prescribed measures required to be taken in cash handling had not been enforced.

5.1.19 Absence of physical verification of stock

Rule 195 of AFR provides that the balance in stock be physically verified half yearly. Scrutiny of records revealed that physical verification of stock of stationery and other material including furniture and fixture had not been done during 2002-07 in any of the five offices test checked. Thus, control measures prescribed for stock and stores were not followed.

5.1.20 Lack of response to audit

Observations as a result of audit by the Principal Accountant General (Audit), (PAG) Assam are communicated through Inspection reports (IRs) to the Heads of Offices/Departments concerned. First replies to the IRs are to be sent to the PAG within four weeks from the date of issue of IRs. A half yearly report on pending IRs is also sent by the PAG to the Secretary of the concerned Administrative Department to

facilitate monitoring the action taken by the Department concerned on audit observations.

As of December 2006, 220 paragraphs relating to 76 IRs pertaining to the period from 1994-95 to 2005-06, as shown in Table-2 below, were pending settlement by various DDOs including Registrar of Co-operative Societies.

Table-2

Year*	Number of IRs pending settlement	Number of paras involved
1994-95 to 2001-02	41	91
2002-03	15	51
2003-04	7	32
2004-05	8	21
2005-06	5	25
Total	76	220

* Audit for 2006-07 has not been conducted.

Further, out of 220 paragraphs, even first replies were not furnished to PAG in respect of 39 paragraphs relating to 7 IRs. Failure to ensure expeditious settlement of the audit objections relating to various irregularities brought out in the IRs may lead to continuation of the financial irregularities and financial mis-management in the future transaction of the Department.

5.1.21 Idle manpower

Scrutiny of records of the RCS revealed that the Department had 10 vehicles on road as on 31 March 2004. Details of vehicles prior to March 2004 were not furnished to audit. The Department, however, entertained 47 drivers during the period from April 2004 to March 2007. Thus, the expenditure of Rs.61.45 lakh (calculated at the minimum of the time scale) towards pay and allowances of 37 idle drivers from April 2004 to March 2007 was unfruitful.

The Department stated (June 2007) that 62 drivers were originally appointed against 62 numbers of sanctioned vehicles available with the Department and became idle due to non-replacement of condemned vehicles by new ones. Since their appointment was made on regular basis they could not be discharged from service and had to be retained.

The reply of the Department is not tenable as they did not initiate any action for gainful utilisation of these idle drivers in other Departments of the Government.

OPERATIONAL CONTROL

5.1.22 Cases of misappropriation, embezzlement, fraud and losses by departmental officers

The Department arranges financial assistance for Co-operative Societies in the form of loans, grants etc. from its plan funds and also through National Bank for Agriculture and Rural Development and National Cooperative Development Corporation. To safeguard the State Government's investments in Societies, departmental officers/staff are deputed under Section 35 of Assam Co-operative Societies Act, 1949 for financial management and control of day to day affairs of the

Societies. As of March 2007, the State Government placed the services of 403 Secretaries (of the rank of Senior Auditor/Inspector) with equal number of Societies. Despite these measures, a number of financial irregularities viz., misappropriation, embezzlement, fraud and losses involving the departmental officials i.e. Secretaries were noticed in audit of Societies by the Senior Auditors of Co-operation Department during the five years ending 31 March 2007 as shown in Table-3 below:

Table-3

(Rupees in crore)

Year	Opening balance		Addition during the year		Total		Settled and recovery effected		Closing balance	
	No. of cases	Amount	No. of cases	Amount	No. of cases	Amount	No. of cases	Amount	No. of cases	Amount
2002-03	358	1.33	--	--	358	1.33	--	0.08	358	1.25
2003-04	358	1.25	4	0.72	362	1.97	--	0.11	362	1.86
2004-05	362	1.86	--	--	355	1.86	7	0.14	355	1.72
2005-06	355	1.72	9	0.11	364	1.83	--	0.17	364	1.66
2006-07	364	1.66	NA	0.28	364	1.94	4	0.15	360	1.79
Total								0.65		

Source: Departmental records

The misappropriation was caused by way of cash embezzlement, non deposit of sale proceeds, shortage in stock of goods etc. by the Secretaries of the Co-operative Societies. This indicates that the Secretaries did not function in accordance with the rules of the Department and the RCS did not ensure their effectiveness in streamlining the administration and control of the finances of these societies. Thus, the purpose of placing the services of Government officials did not serve the intended purpose.

The Department stated (June 2007) that the misappropriated money was being recovered in installments from the salaries of those secretaries and during 2002-07 a sum of Rs.65 lakh was recovered leaving a balance of Rs.1.79 crore in 360 cases yet to be settled (March 2007).

5.1.23 Non recovery of loans

Loans were sanctioned by the State Government for providing financial help to the societies to meet their establishment expenses and implement various schemes. No fresh loans were sanctioned during the years 2002 to 2007. Information furnished by the Registrar showed that only an amount of Rs.0.23 crore was recovered against outstanding loans of Rs.50.30 crore during 2002-07. Further, the Department realized Rs.21 lakh as interest but did not calculate the actual amount of interest realizable from the societies.

Reasons for non/negligible recovery of loans were neither available on record nor stated to audit. Details of the societies defaulting in repayments was also not available on record.

The above position indicates that the Department did not conduct proper scrutiny of proposals of financial assistance and did not assess the viability of the societies before sanctioning the loans to them. Also, there was no monitoring mechanism to ensure proper follow up. The Department had not initiated legal action for recovery of long overdue loans till date (May 2007).

5.1.24 *Control through elected Managing Bodies*

According to Section 32 of the Act (amended in May 1998), election of the Managing Body (MB) of the societies should be held once in every three years. If the election is not held on expiry of three years, the Registrar may appoint an officer(s) or any ad-hoc body to manage the affairs of the society. The officer(s) or the ad-hoc body so appointed should arrange to hold the elections within 90 days of such appointment.

Scrutiny of records of the Registrar however, disclosed that election for the MB were not held in 50 societies as of March 2007. The working of the societies was being managed by the departmental officers (13 societies) and ad-hoc body (37 societies) appointed by the Registrar. The Department however could not specify the number of societies being managed by the departmental officers/adhoc body for more than 90 days. Therefore, the control mechanism through elected bodies was not being followed.

5.1.25 *Deficiencies in Audit of Co-operative Societies*

Audit of the accounts of every registered society is conducted annually by the departmental Auditors under Section 55 of the Act. Records indicated a huge shortfall in conducting audits of society as detailed in Table-4:

Table—4

Year	Number of societies planned for audit	Number of societies audited	Shortfall	Percentage of shortfall
2002-03	8303	5585	2718	33
2003-04	8111	5431	2680	33
2004-05	8243	5141	3102	38
2005-06	6686	4591	2095	31
2006-07	7789	4119	3670	47

Source: Departmental records

Shortfall of audit of Societies ranged from 31 percent to 47 percent in the five years covered under the review. Reason for shortfall was attributed by the Department to non-submission of Annual Accounts by the societies. This reply is not tenable as Section 56 of the Act empowers the Registrar or the Officer authorised by him to cause the accounts to be drawn up at the expenses of the societies and conduct audit thereof.

Thus, non-adherence to the provisions of the Act led the audit of the Societies falling in arrears and the Department remained unaware of the state of affairs of these unaudited societies.

5.1.26 *Delay in liquidation proceedings*

As per sections 65-68 of the Act, winding up of closed and defunct societies is one of the important duties of the Department. Departmental Officers are appointed as liquidators of such Societies. Liquidation proceedings are to be completed within 5 years as required under Rule 100 of the Assam Co-operative Rules 1953. Undue delay in finalisation of liquidation proceedings results in unnecessary waste of assets and continuation of recurring liabilities (pay & allowances of staff/officers and other expenditure).

Details of liquidation cases were not available in the office of the Registrar. However, on demand, the JRCS, Guwahati stated that liquidation proceedings of 229 Societies were pending as of March 2007 without mentioning the details of the societies brought under liquidation, appointment of liquidator, details of assets etc. Thus, the Registrar is not even aware of the societies under liquidation in the State.

However, test check of records in the DRCS Kamrup revealed that finalisation of liquidation proceedings of 5 societies was pending (March 2007) for periods ranging from 7 to 31 years.

Under Section 66 (2) of the Act, the liquidator of a Society should take possession of the assets of the Society under liquidation. "Rampur Mauza Co-operative credit society Ltd.", was brought under liquidation on 5th December '1975. But the liquidator had not taken possession (July 2007) of 3 Katha 5 Lecha of land and cash of Rs.0.63 lakh (in Bank) of the Society despite the lapse of more than 31 years.

This indicates complete failure of operational control at the level of the Department as well as liquidator as required under the Act.

Internal Audit

5.1.27 Absence of internal audit

Internal Audit as an independent entity within or outside the Department, is to examine and evaluate the level of compliance with the departmental rules and procedures so as to provide independent assurance to the management on the adequacy of the risk management and internal control framework in the Department. It was seen that Internal Audit function had not been set up in the Department as of 31 March 2007.

In the absence of an Internal Audit wing, periodical inspection of records was never carried out either at the Headquarters or at the District/Sub-Divisional Offices. This has affected the accountability mechanism in the Headquarters as well as lower formations thereby facilitating financial irregularities remaining undetected.

Supervision and Monitoring

5.1.28 Deficient Monitoring System

Monitoring is an important control tool, which should be exercised by a Department effectively. Efficiency of monitoring is reflected in the timely submission of the prescribed reports and returns to the appropriate authority. Monthly reports on expenditure, progress of liquidation cases, bakijai¹ cases, closing of liquidated Societies, and Registration of new Societies and quarterly reports on progress on audit of co-operative societies, and collection of audit fee etc. were not rendered by the field offices regularly. These were submitted only when called for by higher authorities and in an adhoc manner without any periodicity. This indicates that the Department did not have proper monitoring mechanism.

5.1.29 Conclusion

As brought out in the foregoing paragraphs the internal controls viz, budgetary control, expenditure control, operational control, administrative control, internal audit and monitoring mechanism were inadequate or ineffective in the Department.

¹ Bakijai Cases: Suit for recovery of over due loan etc. through District Administration.

Important reports and returns were not received from the field offices and proper cash management was disregarded. Internal audit was totally absent. Large number of cases of misappropriation, fraud, embezzlements etc. in the Co-operative Societies were not investigated and as such, misappropriated money could not be recovered. Basic principles of democratic working of Societies were not adhered to due to not conducting elections to MBs of societies in time.

5.1.30 Recommendations

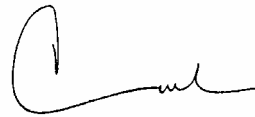
- Budget should be prepared on a realistic basis and savings may be surrendered on a timely basis.
- Strict vigilance on the Secretaries of the Co-operative Societies should be ensured to avoid fraud, misappropriation etc.
- Elections to MBs of societies should be held on a timely basis.
- The Department should immediately set up an internal audit wing to facilitate prompt detection and rectification of financial irregularities.
- Monitoring mechanism should be strengthened.



**Guwahati
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Countersigned



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