



CHAPTER V

**INTERNAL CONTROL SYSTEM AND
INTERNAL AUDIT**

**Internal Control System and Internal Audit in Housing
Department**

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HOUSING DEPARTMENT

5.1 Internal Control System and Internal Audit in Housing Department

Highlights

Internal control system is an integral process by which an organisation governs its activities to effectively achieve its objectives. A built-in internal control system and strict adherence to statutes, codes and manuals minimise the risk of errors and irregularities and helps to protect resources against loss due to wastage, abuse and mismanagement. An evaluation of the internal controls and internal audit system in the Housing Department revealed weaknesses in internal controls in vogue in the Department, such as, non-compliance with rules, programme management, etc.

- **There were deficiencies in budgetary control leading to persistent savings, and delayed submission of budget estimates.**

(Paragraph 5.1.7)

- **Failure in control over expenditure resulted in insignificant capital expenditure, non-reconciliation of expenditure and unauthorised maintenance of bank account.**

(Paragraph 5.1.8)

- **Shortfall in providing housing assistance to 5,194 targeted families indicated inadequate programme management in the Department.**

(Paragraph 5.1.9.1)

- **There were deficiencies in material management and control over quality leading to absence of physical verification of stores and procurement of material without ensuring its quality.**

(Paragraphs 5.1.9.2 & 5.1.10)

5.1.1 Introduction

Internal controls provide reasonable assurance to the management that financial interest, assets and other resources of the organisation are safeguarded and reliable information is available. Internal auditors, as an

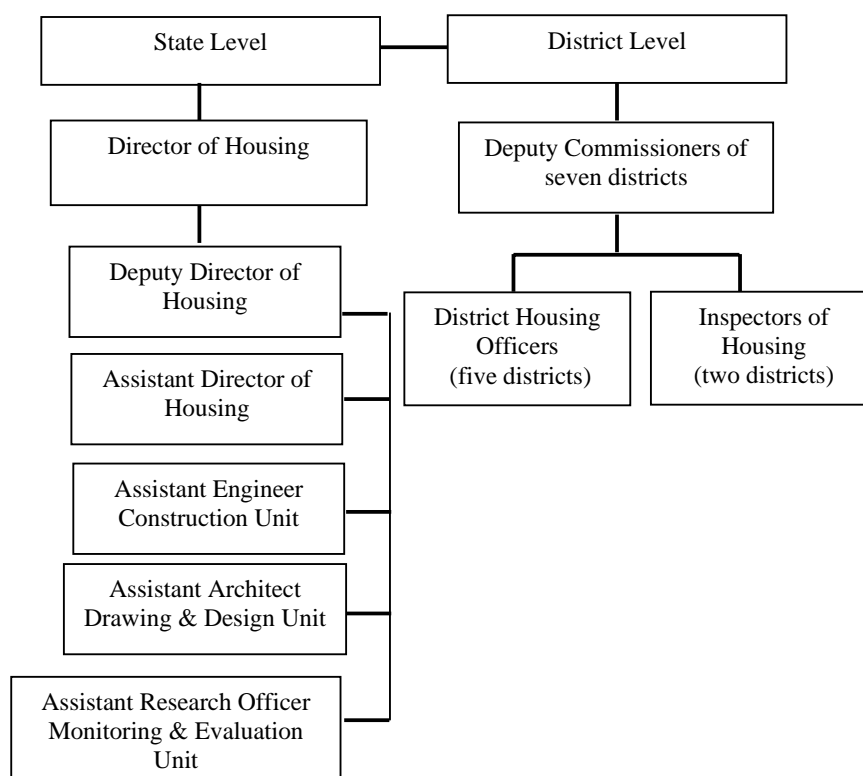
independent entity, examine and evaluate the level of compliance with the departmental rules and procedures and provide independent assurance to the management on the adequacy or otherwise of the existing internal controls.

The primary objective of the Housing Department is to help the rural poor families in the State to own an affordable shelter which is durable and habitable.

5.1.2 Organisational Set Up

At Government level, the Commissioner and Secretary of the Department is responsible for overseeing the functions of the Department. The organisational set up of the Department is as under:

Chart 5.1



5.1.3 Scope of Audit

Adequacy and effectiveness of the internal control system including internal audit arrangements in the Housing Department during 2002-07 were reviewed in audit through a test-check (August-September 2007) of the records of the Commissioner and Secretary of the Department, Director of Housing (DoH) and three District Housing Officers¹ (DHO) (out of five). Results of the review are discussed in the succeeding paragraphs.

¹ East Khasi Hills, Jaintia Hills and Ri-Bhoi.

5.1.4 Audit Objectives

Audit objectives were to see whether the internal control system of the Department is efficient to achieve the objectives of the Department through the following controls:

- Financial controls;
- Expenditure controls;
- Operational controls;
- Management controls;
- Monitoring; and,
- Effectiveness of internal audit.

5.1.5 Audit Criteria

- Internal controls prescribed by the Government/Department;
- State Treasury Rules;
- Provisions of State Financial Rules; and,
- Rules and guidelines issued by the Government from time to time.

5.1.6 Audit Methodology

The review commenced with an entry conference (August 2007) with the Director of Housing in which the audit objectives, criteria and methodology were explained. For the purpose of the review, districts were selected on the basis of random sampling. Information furnished by the Department in response to audit queries and questionnaires were used as audit evidence. The audit findings were forwarded to the Commissioner and Secretary of the Department in September 2007 for acceptance of facts and figures and offering of comments, if any. Audit findings were also discussed (October 2007) with the Commissioner and Secretary of the Department in an exit conference. But para-wise replies to the observations made in the review were not furnished during discussion.

5.1.7 Financial Control

5.1.7.1 Budgetary Control

Budget estimates and actual expenditure of the Department during 2002-07 were as under:

Table 5.1

(Rupees in crore)

Year	Section	Budget provision	Actual expenditure	Savings (percentage)	Amount surrendered	Unsurrendered savings (Percentage to total savings)
2002-03	Revenue	13.83	6.11	7.72 (56)	7.77	...
	Capital	0.85	0.36	0.49 (58)	0.49	...
2003-04	Revenue	8.59	6.77	1.82 (22)	1.83	...
	Capital	5.12	0.22	4.90 (96)	4.90	...
2004-05	Revenue	8.65	8.25	0.40 (5)	0.39	0.01 (2.5)
	Capital	3.49	0.20	3.29 (94)	2.79	0.50 (15)
2005-06	Revenue	9.80	9.34	0.46 (5)	0.47	...
	Capital	1.85	0.70	1.15 (62)	1.15	...
2006-07	Revenue	20.20	17.89	2.31 (11)	0.32	1.99
	Capital	1.80	0.81	0.99 (55)	1.00	...
Total	Revenue	61.07	48.36			
	Capital	13.11	2.29			

Source: Appropriation Accounts (Grant No. 28).

The following shortcomings were noticed in budgetary control:

5.1.7.2 Persistent Savings

There were persistent savings in all the years during 2002-07. The wide variation between budget provision and actual expenditure indicated flaws in budgeting particularly under capital section, where the shortfall in expenditure ranged from 55 to 96 per cent.

5.1.7.3 Delay in submission of Budget estimates

The controlling officers (CO) are provided with blank forms by the Finance Department for submission of consolidated estimates within the prescribed date fixed by the latter.

Scrutiny revealed that submission of consolidated estimates for the years 2002-07 by the CO to the administrative department were delayed by 48 to 164 days leading to delay in submission of the same to the Finance Department by the administrative department. The overall delay in submission of the estimates to the Finance Department was between 63 and 173 days leaving little scope for the Finance Department to scrutinise the same. Thus, there was lack of proper control at the level of the administrative department in processing the budget estimates, which resulted in unrealistic budget provision and consequently, huge savings year after year.

The DoH stated (October 2007) that steps were being taken to rectify the problem of late submission of budget proposal.

5.1.8 Expenditure Control

5.1.8.1 Insignificant Capital Expenditure

Out of the total budget provision of Rs.74.18 crore during 2002-07, the share of capital expenditure constituted only 18 *per cent* (details in Table 5.1). The capital expenditure (Rs.2.29 crore) constituted only 4.5 *per cent* of the total expenditure (Rs.50.65 crore) during the period. The decrease in capital expenditure over the five year period indicated slow pace of infrastructure development in the Department.

The DoH stated (October 2007) that the infrastructure development was badly affected due to non-availability of sufficient funds. The reply is factually incorrect, since the Department could not even utilise the available funds. Also, revenue expenditure of Rs.48.36 crore during 2002-07 against Rs.2.29 crore on capital expenditure showed the apathy of the Department towards infrastructure development.

5.1.8.2 Non-reconciliation of Expenditure

According to the Budget Manual, reconciliation of CO's figures of expenditure with those booked in the accounts of the Accountant General (AG) should be done periodically.

Discrepancies noticed between the CO's (DoH) figures and those reflected in the Appropriation Accounts prepared by the AG (Accounts & Entitlement) for the period 2002-07 were as under:

Table 5.2

(Rupees in lakh)

Year	Plan/Non-Plan	Expenditure as per accounts of the AG	Expenditure as per the Department	Variations Excess (+) Less (-)
2002-03	Plan	519.71	524.24	(+) 4.53
	Non-Plan	127.31	117.82	(-) 9.49
2003-04	Plan	568.35	573.86	(+) 5.50
	Non-Plan	130.87	123.87	(-) 7.00
2004-05	Plan	697.14	702.26	(+) 5.13
	Non-Plan	147.53	143.70	(-) 3.84
2005-06	Plan	850.53	851.74	(+) 1.21
	Non-Plan	152.74	150.98	(-) 1.77
2006-07	Plan	688.87	683.78	(-) 5.09
	Non-Plan	1181.24	173.51	(-) 1007.73

Source: Information furnished by the DoH and Detailed Appropriation Accounts.

As can be seen above, there is a wide variation between the two sets of figures. While the Department booked excess expenditure under plan head during 2002-06, the books of AG reflect higher expenditure in non-plan heads. This is especially so during 2006-07, where the discrepancy is of the order of Rs.10 crore.

The discrepancies were due to non-reconciliation of expenditure during 2002-07 by the DoH with the AG.

5.1.8.3 Unauthorised Opening of Bank Account

According to Rules 4 and 8 of the Meghalaya Treasury Rules, 1985, unless otherwise prescribed, moneys credited to Government Account shall be held either in a State Treasury or in the Bank. A Government officer may not, except with the specific permission of the Government, deposit in a bank, other than the State Bank or its agent for the purpose of Government transactions.

It was noticed that since 21 April 2004, the DoH had been maintaining a joint savings bank account with the Vijaya Bank, the other joint holder of the account being a State autonomous body, viz., Meghalaya State Housing Board. Permission of the Government for opening the joint account, as required under the Treasury Rules, was, however, not obtained.

The DoH stated (October 2007) that Government sanction was usually received on the night of 31st March and the amount had to be drawn immediately to avoid lapse of sanction. As all the nearby State Banks were extremely busy, the amount was temporarily deposited in the nearby nationalised bank and subsequently, ex post facto approval for opening bank account was sought. The reply is not acceptable because the Treasury Rules do not permit operating of such joint account in any bank.

5.1.8.4 Compliance with Rules

According to Rule 103 of the Meghalaya Financial Rules, 1981, the Head of the office is personally responsible for the accuracy of the cash book and cash balance. The cash book should be closed and balanced each day under the dated initial of the Head of the office or his authorised representative. The balance of each column at the end of the month should also be verified with the balance of cash in hand and a certificate should be recorded in the cash book under the signature of the officer responsible for the money.

Scrutiny of cash book of the DoH for the period from 2002-07 revealed that the analysis of closing balance was never done and recorded in the cash book. The certificate of physical cash verification at the end of each month was also not recorded regularly thereby violating the provisions of the Financial Rules.

Failure to maintain the cash book as per prescribed provisions was not only indicative of serious deficiency in operational control but also fraught with the risk of fraud or misappropriation. The DoH stated (October 2007) that provisions of rules regarding maintenance of cash book were being complied with.

5.1.9 Operational Control

5.1.9.1 Programme Management

Rural Housing Scheme was the only major and important scheme which was being implemented by the Department out of the State Plan Fund. The objective of the scheme was to extend housing assistance in the form of three bundles (21 sheets) of corrugated iron (CGI) sheets to the poor families living in rural areas of the State.

The targets and achievement in the coverage of families in terms of distribution of CGI sheets during 2002-07 are given below:

Table 5.3

Year	Number of families targeted for supply of CGI sheets	Number of families sanctioned	Number of families supplied with CGI sheets	Shortfall in sanction with reference to target	Shortfall in coverage with reference to target
2002-03	5,500	5,280	5,256	220	244
2003-04	3,271	3,165	2,957	106	314
2004-05	5,042	3,855	3,793	1,187	1,249
2005-06	4,803	2,913	2,823	1,890	1,980
2006-07	3,772	2,517	2,365	1,255	1,407
Total	22,388	17,730	17,194	4,658	5,194

Source: Information furnished by the DoH.

The above table shows that against 22,388 families targeted for extending housing assistance during 2002-07, sanction was accorded to 17,730 families and assistance was provided only to 17,194 families. Reasons for not sanctioning housing assistance to 4,658 targeted families as well as the shortfall in coverage of 5,194 families despite sanction were not on record.

The above position indicated that adequate attention was not paid to programme management in the Department.

The DoH stated (October 2007) that appropriate steps were being taken for early achievement of targets.

5.1.9.2 Material Management

Rule 197 of the Meghalaya Financial Rules, 1981 provides that the balance in stock should be verified biannually to see whether the balance in hand represents the quantities as well as the value shown in the accounts books. Any discrepancy discovered in the verification should be fully explained and the book balance set right under orders of the competent authority. For distribution to the beneficiaries under the Rural Housing Scheme (three bundles or 21 sheets per family), CGI sheets are procured by the Department either directly from the Steel Authority of India Limited (SAIL) or through their authorised local dealer.

The position of CGI sheets procured by the DoH during 2002-07 for distribution to the beneficiaries of the three test-checked districts was as under:

Table 5.4

(Rupees in lakh)

District	Quantity of CGI sheets procured during 2002-07		Book balance of quantity lying in store as of March 2007	
	Number of pieces	Cost	Number of pieces	Value
East Khasi Hills	1,17,284	712.97	24,947	110.13
Jaintia Hills	57,826	360.57	12,903	57.25
Ri-Bhoi	33,563	203.16	5,867	25.81
Total	2,08,673	1276.70	43,717	193.19

Source: Information furnished by the DHOs.

The above table shows that during 2002-07, the DoH procured 2,08,673 pieces of CGI sheets at a cost of Rs.12.77 crore. As per book balance of March 2007, 43,717 pieces of these sheets worth Rs.1.93 crore were lying in store of the DHOs of three districts. But physical verification of these stores was never carried out in any of the districts during the period 2002-07 to ascertain whether the balance in stock was in conformity with the book balance. This indicates serious deficiency in control over material management and is also fraught with the risk of loss to the Government due to shortage/theft of CGI sheets.

The DoH stated (October 2007) that efforts were being made to avoid deficiency in control over material management.

5.1.10 Quality Controls

During 2002-07, the DoH procured 2,979.43 tonnes of CGI sheets (cost: Rs.12.77 crore) from a Shillong based dealer of the SAIL for distribution to the rural habitations of three test-checked districts under the Rural Housing Scheme. The rates of the sheets having the same thickness (0.63mm) and size (300mm X 800mm) were fixed taking into account the classes, such as, IS 277 Class I, II, III, etc. But no record in support of any system/mechanism prescribed/adopted by the Department to check the classes of sheets procured from the dealer for distribution to the rural populace before making payment to the dealers was produced to Audit.

The DHOs of three test-checked districts stated (September 2007) that screw gauge and measuring tapes were used for measuring thickness and size of the CGI sheets for random check. The DoH stated (October 2007) that the class of the CGI sheets was checked against the sample supplied and the technical personnel conducted random physical checking to ascertain the quality. In the absence of weighing machines till November 2004 (weighing machines were installed in three districts during December 2004 and March 2005), the correctness of payments made to the dealers for the CGI sheets and the quality of sheets distributed to the rural populace remained doubtful. Since there was no recorded evidence about the quality of sheets, Audit could not ascertain the

quality of the sheets procured for supply to the beneficiaries of the test-checked districts.

5.1.11 Management Controls

5.1.11.1 Failure to Enforce Accountability for Non-settlement of Inspection Reports of the Accountant General

The irregularities noticed during local audit conducted by the AG are communicated through Inspection Reports (IRs) to the Heads of offices inspected with a copy to the next higher authorities. A half-yearly report of pending IRs is sent by the AG to the Secretary of the concerned administrative department to facilitate monitoring of the action on the reports.

As of March 2007, 58 paragraphs relating to eight IRs in respect of the Department were outstanding either due to non-receipt of replies or because the replies were incomplete. The details are as under:

Table 5.4

Year	Number of outstanding Inspection Reports	Number of outstanding paragraphs
Up to 2003-04	6	40
2004-05	1	6
2005-06	1	12
Total	8	58

Pendency of IRs indicated failure of the controlling officer to initiate action in regard to the points raised in the IRs. The concerned Secretary of the administrative department also failed to ensure timely action by the concerned controlling officers to address the control weaknesses.

5.1.12 Monitoring

Monitoring is an important control tool, which should be exercised by a department very effectively.

The DoH stated (August 2007) that periodical report on the progress of implementation of housing schemes were called from the districts. But no such report could be produced to Audit. In the absence of the relevant records, Audit could not assess the adequacy of monitoring mechanism. Evaluation of the schemes was also not done and as such, the impact of the schemes remained un-assessed.

5.1.13 Effectiveness of Internal Audit

5.1.13.1 Non-existence of Internal Audit

Internal audit is a useful tool to judge the efficiency of an internal control system. Government Notification of October 1990 empowers the Examiner of Local Accounts (ELA), Meghalaya to examine and carry out the audit of

accounts of various Government departments. Such audit is taken up by the ELA only when a request comes from the respective heads of the departments/offices.

According to the information furnished (August 2007) by the DoH, internal audit of the Department was never conducted during the five year period ending March 2007.

Thus, the adequacy and effectiveness of the accounting and internal control system were not evaluated by the DoH through an independent agency.

The DoH stated (October 2007) that the matter would be taken up with the Government for appropriate action.

5.1.14 Conclusion

Internal controls were inadequate and ineffective in the Housing Department. Arrangements for internal audit were also inadequate. Despite availability of adequate funds for capital works, the Department provided housing assistance to less than the number of targeted families which is indicative of poor budgetary, financial, operational and monitoring controls. The review of the working of the Department also revealed weaknesses in material management. Material were procured without ensuring its quality and no physical verification of the stores was conducted. Internal audit of the Department was never conducted during the review period.

5.1.15 Recommendations

- **Internal controls in the Department need to be strengthened with regard to finalising budgetary estimates on time and monitoring the expenditure.**
- **Cash Book should be maintained in accordance with the relevant rules to avoid fraud or misappropriation of funds.**
- **Effective quality control mechanism should be put in place to ensure receipt of material as per proper specification.**
- **Internal audit should be undertaken to evaluate the efficiency of the internal control system and the adequacy of the accounting system.**

The matter was reported to the Government in September 2007; reply had not been received (February 2008).