

CHAPTER-V

Internal Audit System

5.1 Internal Audit Arrangements within the Government

FINANCE DEPARTMENT

5.1.1 Introduction

The auditing arrangements existing within the Government of Orissa consist of (i) Internal Audit System known as Common Cadre Audit (CCA) in 20 of the 38 civil departments¹, (ii) Local Fund Audit Organisation (LFA) which is the statutory auditor of Panchayati Raj Institutions and Urban Local Bodies, (iii) Efficiency Audit Organisation to conduct selected evaluation studies and (iv) Gram Panchayat Audit (GPA) Organisation for audit of Gram Panchayats in the State. The LFA also conducts audit of aided schools, endowments etc.

5.1.2 Organisational set-up

The Organisational chart of (i) Common Cadre Audit (CCA), (ii) Local Fund Audit (LFA), (iii) Efficiency Audit and (iv) Gram Panchayat Audit (GPA) is given in Appendix-XXXVI. These units except the CCA are under the control of the Finance Department. Up to March 2003, the GPA was under the control of Panchayati Raj Department. The CCA is separate for each department and functions under the control of the Financial Advisor of the respective departments.

5.1.3 Scope of review

A review was conducted of the activities of these units through test check of records of Agriculture, Health and Family Welfare, SC and ST Development and Finance Departments during September and October 2003 for the period from 1998-99 to 2002-03. Besides, the activities in the District Audit Offices, Cuttack and Bhubaneswar under the LFA and District Panchayat Offices, Khurda and Puri under the GPA were reviewed in audit. The following points were covered.

- Audit Planning and Execution
- Audit Reporting and Follow-up

¹ There is no internal audit system in 15 departments including Home, Excise, Transport and Industries Departments. The Engineering Departments where the system of Divisional Accountants is in vogue also do not have any internal audit system.

- Staffing and Training and
- Effectiveness of Internal Audit

5.1.4 Common Cadre Audit (CCA)

The sanctioned strength and men in position of the CCA as a whole, for all departments of the Government taken together, are given below:

Category	Sanctioned Strength		Men in Position	
	1998-99	2002-03	1998-99	2002-03
Auditor	469	447	416	372
Audit Superintendent	46	51	45	51
Audit Officer (Gr-B)	6	11	4	11
Audit Officer (Gr-A Jr)	2	3	2	2
Audit Officer (Gr-A Sr)	-	1	--	--

There was no recruitment of auditors since 2000 to fill up the vacancies.

Agriculture and SC and ST departments did not prepare annual or periodical audit plans (except for SC and ST Department for 1998-99). Health and Family Welfare Department, however, prepared annual plans for all the five years on the basis of available manpower, quantum of expenditure and arrears position. Certain factors such as importance of the subordinate offices, allotment of funds and arrears position were generally considered for selecting a unit for audit. However, no formal risk analysis of the units based on fund allotment, importance of activities and other risk factors had been made.

It was necessary to make a risk analysis of units and assign longer audit periodicity (biennial, triennial etc.) to less important units. Further, it was also necessary to do away with the present system of 100 *per cent* audit of receipts and expenditure and adopt selective audit techniques to enable the available manpower to audit all the units in time.

It was noticed that an audit party consisting of an auditor or two were deputed to a subordinate office for conducting audit. The party examines the records and at the end of audit prepared a draft audit report taking into consideration the replies of the subordinate office to its queries and submitted it to the audit superintendent who was to review it. The draft report was then submitted through a hierarchy to the Secretary for approval.

The following deficiencies were noticed:

- The CCA did not have an audit manual for its auditors.
- Auditors' work in the field was not supervised.
- Auditors did not as a rule verify whether the subordinate offices furnished compliance to the audit observations of external auditors.

The audit reports, after review and approval by the Secretary were issued to the sub-ordinate office for compliance within three months.

Test check of 60 audit reports in three test checked departments revealed that the audit reports, required to be issued within two months from the date of completion of audit, were issued after a delay of 2 to 37 months. There were 258 audit reports for the period from 1999-2000 to 2002-03 pending (Agriculture: 181, SC and ST Development: 41 and Health and Family Welfare: 36) for issue as of October 2003.

No compliance was received within the stipulated time in respect of any of the audit reports test checked. Further, no reports pertaining to non-compliance by sub-ordinate offices were prepared or submitted to the FA or Secretary for monitoring. No meetings were held with the subordinate offices for ensuring early compliance to the audit reports.

Thus, monitoring of compliance to audit reports at higher level needs improvement, if any benefit is to be derived from internal audit.

As of March 2003, audit was in arrears in all the three selected departments as shown below:

	Agriculture	SC and ST Development	HFW
Number of units	345	334	535
Number of units in arrears	345	286	Not Available
Number of Annual Accounts for which audit was in arrears	7169	1235	Not Available

Arrears were attributable to lack of adequate manpower and inadequate utilisation of available manpower. In the year 2002-03, as against the available 7200 mandays in the SC and ST department, 4884 (68 *per cent*) mandays only were utilised in field audit. Utilisation of 32 *per cent* time in headquarters' work indicated less mandays utilisation in field audit. In HFW Department, however, 82 *per cent* mandays were utilised in field duty. The effect of higher mandays utilisation in this department was, however, not ascertainable.

The Agriculture Department fixed no annual targets for audit. The SC & ST Development Department fixed the targets for 1998-99 and 2002-03. Against the 2002-03 target of audit of 87 units covering 512 Annual Accounts, the department could audit 53 units covering 162 Annual Accounts (32 *per cent* of the target). The HFW Department fixed the annual targets for all five years. However, against their 2002-03 targets of 86 units, the department could audit only 32 units (37 *per cent* of the target).

Shortfall in achievement of targets was attributable to setting of targets without taking into account the limited resources. The departments did not have any plan for clearing audit arrears.

No consolidated reports on outstanding audit reports and paragraphs were prepared. Therefore, the position of outstanding audit observations and their year-wise break-up was not available.

The CCA covered 20 out of 38 departments of the Government of Orissa. There was no arrangement for internal audit in 15 departments. Some departments did not have audit officers/audit superintendents to review the audit work. For example, in three departments viz. Science and Technology, Public Enterprise and Steel and Mines, there is only one auditor each in their internal audit wings. Obviously, the coverage of internal audit was inadequate.

5.1.5 Local Fund Audit (LFA)

The LFA organisation of the Finance Department functions under the authority of the Orissa LFA Act, 1948. It conducts audit of the accounts of the Local Fund Authorities, i.e. PRIs, Urban Local Bodies (ULBs), Aided Educational Institutions, Universities, Board of Secondary Education, Council of Higher Education, Religious Endowments and some miscellaneous institutions receiving Government grant. The audit conducted by the LFA is of two types, i.e. statutory in respect of PRIs and ULBs etc. and non-statutory in respect of aided schools, endowments etc. The number of units auditable by the LFA is given below:

Name of the Local Bodies	2002-03
Panchayat Samities	314
Urban Local Bodies	102
Education Institutions	9001
University	8
Board / Councils	2
Endowments	398
Miscellaneous	202
Special Planning Authority	15
Total	10042

The LFA auditors have the authority to order production of documents or to summon an official in person. The auditors also have powers to levy surcharge.

The LFA adopted the system of pre-audit in 157 Panchayat Samities since 1998 by posting one auditor in each samiti to apply checks before incurring expenditure.

The auditors of the LFA posted to Panchayat Samities were responsible for proper maintenance of accounts, cash books and relevant records. No bill could be presented to the treasury without the concurrence of the auditor. The District Audit Officers were required to supervise the work of auditors once in three months.

Though the objectives of the pre-audit system seemed foolproof, the results did not seem to be encouraging. A review of 10 blocks, where the pre-audit system existed, indicated no improvement in the state of accounts and financial administration. In spite of the presence of an internal auditor, important records such as registers of outstanding advances, grants-in-aid, property contractors' ledgers, measurement books, stores and suspense accounts etc. were not maintained and the receipts and payments account of grants was not prepared from 1999-2000 onwards.

The audit process consists in audit planning, audit execution and issue of audit reports and their follow-up. The District Audit Officer (DAO) is responsible for the audit of the local bodies and authorities under his jurisdiction.

It was observed that the annual audit plan prepared by the LFA for each audit district and audit party was not based on formal ABC analysis of units under audit, fund flow, the importance of the activities carried out by the offices and other risk factors. As a result, audit of 6494 auditee units (excluding Phulbani, Kalahandi and Cuttack districts) covering 86692 annual accounts were in arrears as of March 2003.

The following deficiencies were noticed:

- The LFA did not have an audit manual for its auditors though instructions were issued by FD regarding conduct of audit.
- Auditors did not verify whether the auditee unit furnished compliance to audit observations of auditors of the Indian Audit and Accounts Department (IA&AD) in respect of Panchayat Samities.

The internal audit reports, after review and approval by the Examiner-cum-Additional Secretary were issued to the auditee units for compliance within three months. Of the 20 audit reports test checked, no compliance was received within the stipulated time.

The audit reports, though required to be issued within two months from the date of completion of audit, were found to have been issued after a delay of 6 to 24 months.

Pertinent topics such as excess liabilities of ULBs, unutilised grants, pending UCs, non-recovery of taxes/licence fees, unauthorised retention of grants in the Personal Ledger Accounts (PLA), diversion of funds from PLA, loss of stock materials etc. find place in the audit reports. Other observations include retention of heavy cash balances, minor procedural irregularities in works etc. However, the following points need remedial action:

No reports pertaining to non-compliance by local bodies/authorities were prepared or submitted to the Examiner-cum-Additional Secretary for monitoring. No meetings were held with the local bodies/authorities by the Higher Management for ensuring early compliance to audit reports. Similarly, no consolidated report on outstanding audit reports and paragraphs was prepared. Clearly, monitoring of compliance to audit reports at higher level needed improvement.

In respect of cases warranting surcharge, show cause notices are issued. However, due to inadequate response from auditee units, the recovery on surcharge proposals could not be effected in a large number of cases.

The LFA did not certify the accounts of the units for which it was the statutory auditor.

The position of annual targets and achievements is given below:

Year	Number of units planned	Number of annual accounts audit planned	Number of units audited	Number of annual accounts audited	Percentage of number of annual accounts audited
(1)	(2)	(3)	(4)	(5)	(6)
1998-1999	716	1938	643	1576	81
1999-2000	821	2563	631	1701	66
2000-2001	797	2615	638	1662	63
2001-2002	566	1176	467	763	65
2002-2003	692	1401	563	1211	86

Shortfall in achievement of targets was attributable to setting of targets without considering the resources available. It was, therefore, necessary for the LFA to concentrate on units for which it has a statutory responsibility for audit. To achieve this, the LFA needs to consider the following:

- To make a formal ABC analysis based on fund allotment, importance of activities and other risk factors of the units and assign longer audit periodicity (biennial, triennial etc.) to non-statutory units.
- To do away with the present system of 100 *per cent* audit of receipts and expenditure and adopt selective audit techniques to enable the available manpower to audit all the units in time.

5.1.6 Efficiency Audit Organisation (EAO)

EAO conducts evaluation studies and internal audit with a detached and objective outlook and brings to notice the defects and deficiencies in the system and suggests remedies. It undertakes special and emergent nature of job, which requires immediate appraisal.

The EAO undertakes special audit on requisition from different organisations, instructions from higher authorities and at times on its own initiative. The scope of EAO audit is determined by the terms of reference of an assignment and generally includes assessment of performance of the activities of a particular department or a particular branch or a probe into any particular problem facing a number of departments.

As the system of audit was totally based on requisition, no annual planning was done. The subject for investigation was studied on the basis of available records, enquiry and discussion with concerned authorities and the scope of

the inquiry and its objectives were determined. It also took up detailed audit of accounts where misappropriation, defalcation or embezzlement of cash was detected either by the department itself or by vigilance.

It was observed that the EAO did not have any audit manual for its auditors. The nature of audit observations was similar to that of the CCA such as mis-utilisation of revenue receipts, misuse of subsidy, irregular adjustment of grants, parking of Government money in savings accounts etc. The audit reports seen in audit did not indicate comprehensive examination from performance angle of the issues involved.

The audit reports, though required to be issued within two months from the date of completion of audit, were not issued in time. Of the 20 audit reports seen in audit, the delay in issue ranged from 3 to 15 months.

The departments did not furnish compliance to audit reports within the stipulated time of three months. Of the 20 audit reports issued during 1999-2003, no compliance report was received as yet in respect of 18 audit reports. In the remaining two cases, the delay in furnishing compliance was 25 to 30 months.

No reports pertaining to non-compliance by subordinate offices were prepared and submitted to the Special Secretary of Finance for monitoring. No meetings were held with the departments for ensuring early compliance to the internal audit reports. The periodical review by the high level committee, as prescribed, was not being done. Similarly, no consolidated report on the outstanding audit reports and paragraphs was prepared. Clearly, monitoring of compliance to audit reports at higher level was absent.

5.1.7 Gram Panchayat Audit (GPA)

During 1966, a separate cadre of auditors was formed under the PR (GP) Department to conduct the audit of GP accounts independently. The responsibility for the GP audit has since been transferred to FD in April 2003. There are 6234 GPs in the State.

In pursuance of the recommendations of the Eleventh Finance Commission, Government of India issued guidelines for the State Governments stipulating that the CAG of India be made responsible for technical guidance and supervision over the proper maintenance of accounts and audit of the PRIs. Government of Orissa entrusted audit of 20 *per cent* GPs to the CAG of India with effect from November 2002 under section 20(1) of the CAG's DPC Act, 1971. The CAG of India prepared the formats of accounts for PRIs. These formats were not adopted in the State.

As at the end of 2002-03, audit was in arrears in respect of 3708 GPs for 11666 Annual accounts due to inadequate manpower. As in case of other wings, the GPA wing too was plagued with delay in issue of audit reports and lack of compliance and follow-up. It was observed that the proforma of the audit report was more accounts oriented. The auditors devoted more time in preparation of accounts rather than auditing. It was therefore necessary to

impart training to GP secretaries to enable them to prepare the accounts; this would relieve the auditors of accounting work.

5.1.8 Internal Auditing Standards

Auditing standards provide benchmarks for judging the performance of auditors and help bring uniformity and excellence in audit processes. The modern trend among audit organisations, therefore, is to adopt a formal set of standards covering general, operational and reporting areas. No audit wing of the State has such auditing standards.

5.1.9 Recruitment and Training

The posts of Audit Officers were filled in by promotion from the cadre of audit superintendents and that of audit superintendents from the cadre of auditors. Direct recruitment was made for 75 per cent posts of auditors through competitive examination conducted by Orissa Subordinate Staff Selection Commission. The remaining 25 per cent posts were filled in by promotion from among the staff of different departments with intermediate qualification. Considering the high responsibility involved in audit, the minimum educational qualification prescribed for internal promotion to auditors' cadre should be raised to graduation.

The quality of auditors' work also depends on the on-site supervision of their work by the audit superintendents. However, the on-site supervision by audit superintendents was minimal due to their number being inadequate. As against the total 957 auditors in all four wings as of March 2003, there were only 103 (11 per cent) audit superintendents. There is a need to enhance the number of audit superintendents' posts. This, apart from improving the quality of audit, will also act as a motivating factor by creating more promotional prospects.

For direct recruits to the cadre of auditors, the duration of induction training is three months. Induction training was also imparted to the departmental candidates promoted to the cadre of auditors. The syllabus for the training is adequate and covers the subjects the auditors are required to know. No information in respect of on the job training was available.

5.1.10 Effectiveness of Audit

- Audit in any organisation is effective only if the auditees view the audit observations seriously and take corrective measures. The position of audit of the State was far from effective in this regard. The auditees either not responded or responded belatedly to the audit observations. No records in support of system changes and improvements following audit observations could be seen during the review.
- The effectiveness of audit also depends on the currency of their audit reports. If the reports pertain to old periods (due to there being arrears in audit), there is little enthusiasm among auditees to act on the audit findings. The balance, therefore, needs to be tilted in favour of audit of current accounts.

- It was noticed that the LFA had been able to raise recovery demands in 4587 cases for Rs.7.40 crore during 2002-03. The actual recovery effected, however, stood at only Rs.3.11 lakh in 111 cases. Nevertheless, the work of LFA on this front contributed to its effectiveness.

5.1.11 Conclusion

Audit can be considered efficient if the quantity and quality of its output are such as to make an impact on the management and promotes good management practices. Quantitatively, the Government could not cover all the units due for audit. Qualitatively, improvements in its audit processes, as pointed out in the preceding paragraphs, are required which received least attention and support from the management of the auditee units as well as the Government departments. Nevertheless, the audit of the State is a conceptually well-organised set-up. The Department has a good infrastructure for training of audit personnel including qualified faculty. However, its efficiency and effectiveness are to be enhanced for effective audit.

The matter was discussed (December 2003) with the Principal Secretary to Government, Finance Department who assured that corrective measures would be initiated wherever necessary.

WATER RESOURCES DEPARTMENT

5.2 Functioning of Stores Verification Wing

The Water Resources Department did not have an Internal Audit Wing. However, a Stores Verification Wing was set up in March 1969 in the department to ensure proper control over inventories to strengthen the internal control system. The organisation headed by a Superintending Engineer under the administrative control of the Commissioner-cum-Secretary to Government, Water Resources Department was to conduct physical verification of stores & stock accounts, tools & plants accounts, segregate surplus materials for disposal, detect obsolescence, pilferage and theft. The organisation was also required to review the Reserve Stock Limit of each division with reference to stock on hand and identify unnecessary purchases. The reports on such exercises were to be forwarded to the Divisional Officers within 30 days of the date of completion of the verification.

Check of records in audit revealed (September 2003) that though the Stores Verification Wing had staff strength of 24, it failed to exercise necessary control over inventory. Physical verification of accounts of 16 divisions² was conducted but verification reports were issued between September 2000 and March 2003 after delays ranging from 3 to 29 months from the

² 1) Puri Irrigation Division, Puri, 2) Rusikulya NWMP Division, Aska, 3) DSARP Division No. II, Sorada, 4) Kanpur Head Works Division, Keonjhar, 5) Stores & Mechanical Division, Ambaguda, 6) DSARP Division No. I, Bhanjanagar, 7) Rourkela Mechanical Division, Panposh, 8) MI Investigation Division, Berhampur, 9) Baghua Irrigation Division No. I, Matajhari, 10) Manjore Irrigation Division, Athamalik, 11) MCII, S & M Division, Cuttack, 12) Mahanadi Barrage Division, Cuttack, 13) Salandi Canal Division, Bhadrak, 14) Parjang Canal Division, Parjang, 15) Mayurbhanj Irrigation Division, Baripada and 16) GWS&I Division, Bhubaneswar.

dates of verification. The reports indicated mismanagement in maintenance of stores valued at Rs.11.87 crore (discrepancies: Rs.9.27 crore, shortages: Rs.1.60 crore, losses: Rs.0.56 crore and excess: Rs.0.44 crore). Of the 16 divisions involved, 11 Divisional Officers furnished first compliance, based on which objections valuing Rs.31.48 lakh (three *per cent*) were settled. As of September 2003, five Divisional Officers did not furnish any compliance.

Compliance in respect of stores valuing Rs.11.55 crore was pending as of September 2003. No remedial measures were taken by the Engineer-in-Chief, Water Resources, being the Head of the Department to ensure compliance and effect timely recovery of shortages from the officers concerned before their superannuation indicating ineffective functioning of the stores verification wing.

Government stated (September 2003) that setting up of Internal Audit Wing was under process.

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