2.2 Rajasthan Rajya Vidyut Utpadan Nigam Limited, Rajasthan Rajya Vidyut Prasaran Nigam Limited, Jaipur Vidyut Vitran Nigam Limited, Ajmer Vidyut Vitran Nigam Limited and Jodhpur Vidyut Vitran Nigam Limited

Evaluation of Internal Control and Internal Audit System in Material Management of Power Sector Companies

Highlights

The companies failed to ensure compliance of the Internal Controls prescribed in the Purchase and Stores Manuals. Top management of these companies did not review and strengthen the internal controls resulting in frequent violations of the control procedures.

(Paragraphs 2.2.7 to 2.2.12)

The companies failed to utilise budget as an effective internal control mechanism. Budget estimates were prepared violating guidelines and there were large variations between budgeted and actual expenditure. The companies did not analyse these variations for corrective action. None of these companies prepared separate material budgets.

(Paragraph 2.2.6)

The companies failed to have effective control over Material Management to prevent excessive purchases or stock-outs. Stores were purchased much in advance of requirements resulting in blockage of funds and lapse of guarantee period before installation. Similarly, procurement of store material was delayed resulting in delay in completion of projects and loss of savings of Rs.3.35 crore from reduced energy losses.

(Paragraph 2.2.9)

The companies did not ensure documentation of transactions and maintenance of important records weakening the Managements' control over the operations of these companies.

(Paragraphs 2.2.13 to 2.2.15)

Physical verification of stores was either not conducted at all or not conducted as per the prescribed periodicity. The companies failed to take remedial action in respect of the shortages/excesses noticed during physical verification.

(Paragraphs 2.2.16 to 2.2.17)

The companies failed to put in place critical controls with regard to the time frame for sending transformers for repair, time period for repairs and monitoring issuance, consumption, return of materials to the contractors and for settlement of advances given to contractors and remedies in case of failure. Absence of these control procedures led to delays in sending transformers for repair, repairs by vendors, settlement of advances/ issuance of materials to the contractors.

(Paragraph 2.2.18)

Internal Audit in these companies was found to be inadequate compared to the size and nature of activities as also pointed out by the Statutory Auditors. As a result internal audit coverage was inadequate, issuance of Inspection Reports was delayed and follow-up was slack.

(Paragraphs 2.2.24 to 2.2.29)

Introduction

2.2.1 Rajasthan State Electricity Board (Board) was set up (July 1957) under the Electricity (Supply) Act, 1948 for managing generation, transmission and distribution of power in the State. The Board sustained losses due to excessive transmission and distribution losses, unremunerative tariff, cross subsidy to agricultural consumer's etc. and the continued negative rate of return adversely affected the credit worthiness of the Board. In order to restore financial viability and to establish credit worthiness of the Board, Government of Rajasthan (GOR) decided (1993) to undertake power sector reforms. Accordingly, the Board was unbundled into five companies [one generation company {Rajasthan Rajya Vidyut Utpadan Nigam Limited (RRVUNL)}, one transmission company {Rajasthan Rajya Vidyut Prasaran Nigam Limited (RRVPNL)} and three distribution companies {Jaipur Vidyut Vitran Nigam Limited (JVVNL), Jodhpur Vidyut Vitran Nigam Limited (Jd.VVNL) and Ajmer Vidyut Vitran Nigam Limited (AVVNL)}] in July 2000.

The RRVUNL generated power through thermal/hydel/gas power stations. The RRVPNL transmitted power from generation points to distribution points. The three distribution companies distributed power upto the consumer point. With a view to fulfill their respective objectives, these companies are required to construct and maintain generating stations, transmission lines, grid sub stations and distribution lines etc. for which various types of materials are purchased and requisite inventories are kept in stores. During 2003-04, the companies spent an amount of Rs.1345.93 crore towards material purchases.

The Board of Directors (BOD) of each company has been given full powers by its Articles of Associations, to take decisions with regard to purchases. Powers for purchases upto Rs.1.50 crore have, however, been delegated to the level of Chief Engineer. The organisation set-up of the Material Management Wing and Internal Audit Wing is given in **Annexure-11.**

Internal control system is a management tool used to provide assurance that management's objectives are being achieved. An effective internal control system is a pre-requisite for efficient functioning of any organisation. It comprises long term and short term planning for achievement of objectives, periodical review of plans, budgetary control mechanisms, control for each responsibility area and accounting procedures to ensure the accuracy and reliability of accounting data.

Scope of Audit

2.2.2 The review for the period July 2000 to March 2005 was conducted during January 2005 to March 2005 covering 13 (38 *per cent*) out of 34 units selected on the basis of risk analysis. The audit findings were reported to Government/ Management of the Companies in April 2005 and discussed at the meeting of the Audit Review Committee for Public Sector Enterprises (ARCPSE) held on 20 July 2005. Secretary (Energy) represented the Government and the Managing Directors of the RRVUNL, RRVPNL, AVVNL and Jd.VVNL and Director Finance of RRVPNL represented the Management. The review was finalised after considering the views of the Government/Management.

Audit Objectives

2.2.3 Evaluation of the Internal Control and Internal Audit System in Material Management of Power Sector Companies was carried out in order to assess whether:

- the purchases were made as per procedures prescribed in the purchase manual.

- management of the company was efficient to safeguard its interest against possible risks to the economy of the purchases made.

- the companies carried out transparent risk assessment associated with various procedures and stages in purchase planning, tender processing, and general conditions of contract / purchase orders.

- internal control and accountability provided sufficient assurance for safeguarding the financial interest of companies.

- proper system of store keeping and accounting of stores existed.

Audit criteria

2.2.4 Evaluation of Internal Control and Internal Audit was done with reference to the existing manualised rules, procedures, Internal Controls and their compliance in material management by these Companies.

Audit Methodology

2.2.5 Based on the preliminary findings of the pilot study, the risk in these companies was perceived to be high in the absence of a proper internal control system in purchases and non-maintenance of prescribed records as per the stores manual.

Detailed testing of records relating to adherence to provisions of purchase/stores manual, estimation of requirements, procurement procedures, stores, physical verification, action for repair, internal audit, issuance of inspection reports and follow up action was carried out during January to March 2005.

Audit findings

2.2.6 Budget and budgetary control

Budget is generally drawn up with a view to plan future operations and to use the same as a tool of internal control by exercising *ex-facto* checks on the results obtained. The companies, however, did not draw up budget estimates looking to these guidelines as even after revising the original estimates; there were variations between actual expenditure and revised estimates, as shown in **Annexure-12**.

It would be seen from the annexure that:

- The revenue expenditure (repair & maintenance) incurred during the years 2001-04 was less than the revised estimates in all the companies except in JVVNL where it was more than the revised estimates. Further, despite downward revision in budget estimates from Rs.50.38 crore to Rs.49.01 crore during 2002-03 and from Rs.53.66 crore to Rs.42.03 crore in 2003-04, RRVUNL could not fully utilise the allocation.

Actual capital expenditure incurred against the revised estimates during the last four years ended 31 March 2004 ranged between 79.13 to 151.31 *per cent* in RRVUNL, 41.99 to 78.19 *per cent* in RRVPNL, 70.96 to 121.91 *per cent* in JVVNL, 61.96 to 143.55 *per cent* in Jd.VVNL and 59.42 to 98.48 *per cent* in AVVNL.

The above indicates that budget/ revised estimates of capital and revenue expenditure were not prepared on a realistic basis.

None of the companies prepared material budget separately. The budget/revised estimates of capital and revenue expenditure were not prepared on realistic basis.

Reasons for wide variations were not analysed by any of the companies. None of the companies prepared material budgets separately. The Management of RRVPNL stated (20 July 2005) that budget allocation is made to the Chief Engineer (Material Management) separately. The fact remains that there is a need to monitor the budget estimates and analyse the budget variations, which was not done.

Audit also could not analyse these variations as none of the companies had prepared separate material budgets.

The Government stated (August 2005) that efforts were being made to prepare the budget estimates as near as possible to the actual expenditure.

2.2.7 Violation of standardised procedure

In the purchase manual, the Companies have prescribed certain procedures, guidelines and instructions for effective control over procurement of stores. Procurement of stores includes assessment of requirement, purchase of stores etc. While reviewing the records relating to procurement of stores, the following deficiencies in internal controls were observed:

Assessment of requirement

None of the companies fixed minimum, maximum and reorder levels. ABC analysis and movement analysis was also not done by any of the companies.

2.2.8 In order to ensure proper control over stores, firm estimates shall have to be made for stores requirements and the requirements should be guided as far as possible through Material Management, which, *inter alia*, includes ABC value analysis and movement analysis. In violation of purchase manual provisions, however, none of the companies' fixed minimum, maximum and reorder levels. A B C analysis and movement analysis was also not done by any of the Companies before finalisation of requirements. Non-fixation of these levels resulted in excess purchase of material (valued Rs.29.88 lakh) by RRVPNL despite having sufficient stock (Rs.42.76 lakh). Government stated (August 2005) that this was practically not possible for working out requirement. Reply is not tenable as these are control tools provided for in the purchase manual to avoid purchases in excess of requirement.

2.2.9 Effective material management requires that assessment of requirement and procurement of material should be such that material does not remain in stock for a long time and also that work should not suffer due to non-availability of material. Audit analysis revealed that:

- Stores (valued Rs.40.98 lakh) purchased from the loan fund received from the World Bank against project financing scheme were received by RRVPNL during June 2003 to June 2004 but no issue of the material was made till July 2005 when material valuing Rs.35.73 lakh was issued. Thus material was procured much in advance of actual requirement and could not be used even after lapse of 13 to 25 months of its purchase. Government stated

(August 2005) that a decision had now been taken to use such material under non-world bank scheme. The reply does not explain why material was purchased for World Bank projects much in advance and in excess of requirement. It was also noticed in audit that unused material included CT/PT transformers valued Rs.26.25 lakh (73.47 *per cent* unused material) for which guarantee period had also expired.

Stores valuing Rs.91.37 lakh were purchased much in advance leading to blockage of funds and lapses of guarantee period.

- RRVPNL placed (15 November 2002) purchase order on BHEL for supply of 45 245 KV Capacitor Voltage Transformers- CVT (TN 3494). As per purchase order, the guarantee period of these CVT was 12 months from the date of commissioning or 18 months from the receipt of last consignment, whichever was earlier. These 45 CVT transformers were received from August 2003 to October 2003 but, due to delay in finalisation of land, line bay work and associated civil works of the respective grid sub-stations 19 CV transformers were commissioned only between March 2005 to May 2005. The procurement of CVTs was thus much in advance of their actual use. Further, the guarantee period for these CVTs expired in April 2005. The company had purchased 19 transformers valuing Rs.55.64 lakh much in advance of their utilisation.

- The Purchase Manual stipulates that item-wise requirement of centrally purchased items shall be finalised at the commencement of the financial year. It was, however, noticed that requirements for the year 2000-01 and 2002-03, were finalised in the months of June 2000 and June 2002 respectively by RRVPNL. Government stated (August 2005) that assessment of requirement was delayed due to revision in Plan. The reply is not tenable, as RRVPNL did not consider the lead-time in procurement of material, resulting in delay in procurement of material.

Delays in assessment of requirement of materials caused delay in completion of projects and deprived the Company from estimated savings of Rs.3.35 crore.

The above requirement of material included towers for construction of 220 KV Single Circuit Ratangarh-Sujangarh line, scheduled to be completed by January 2003. It was noticed during audit that during the previous 2-3 years, the tower suppliers took 14-15 months time for supply of towers. Therefore to complete the line in January 2003 the company should have placed purchase orders by September 2001. The requirement was, however, assessed in June 2002 and purchase orders were placed in October 2002. The supplier also delayed the supplies in this order. Due to delay in providing towers, work could be completed only in February 2005. The delayed completion of line construction deprived the company of anticipated saving of Rs.3.35 crore towards reduction in energy loss which had a cascading effect on the electricity tariff and ultimately on the consumers.

2.2.10 Delay in issue of purchase orders

The purchase manual provides 90 days time for finalisation of purchases from opening of tenders till placement of purchase order falling within competency of the committee of whole time members and 50 days time for purchase falling within competency of other levels. It was, however, observed that the companies did not finalise the tenders within the time prescribed in the manual.

Details of tenders processed by AVVNL, Jd.VVNL and RRVPNL during the last four years and the results of test check conducted in audit are as under:

Years	Name of the company	Total Nos. of tenders invited/ opened	Total Nos. of tenders selected at random	Tenders finalized beyond original validity period	
				Number	Percentage
2001-02	AVVNL	50	13	8	62
	Jd.VVNL	97	26	15	58
	RRVPNL	69	42	29	69
2002-03	AVVNL	32	12	10	83
	Jd.VVNL	60	15	5	33
	RRVPNL	57	32	27	84
2003-04	AVVNL	71	18	12	67
	Jd.VVNL	96	18	6	33
	RRVPNL	66	50	45	90
2004-05	AVVNL	63	17	5	29
	Jd.VVNL	112	33	2	6
	RRVPNL	48	33	26	78

It would be seen from the above table that cases finalized beyond the validity period ranged between 29 and 83 *per cent* in AVVNL, 6 and 58 *per cent* in Jd.VVNL and 69 and 90 *per cent* in RRVPNL. The delay in days ranged between 2 to 278 days in AVVNL, 5 to 247 days in Jd.VVNL and 2 to 239 days in RRVPNL.

AVVNL and Jd.VVNL while accepting that there were delays in finalisation of tenders and placing of purchase orders stated (June 2005) that due to shortages of staff, the tenders could not be finalised in time and efforts would be made to finalise the tenders in time in future. Government endorsed (July 2005) the views of the companies.

2.2.11 Non- operation of risk and cost purchase clause

To ensure timely supply of material, companies specify the supply period in the purchase order. As an effective control to receive supply in time and to deal with the suppliers who failed in the supply, the Purchase Manual stipulates that each order should include a cost and risk purchase clause. Scrutiny of the purchase orders placed by RRVPNL, however, revealed that:

Non-invoking of cost and risk purchase clause resulted in loss of Rs.58.30 lakh.

- Out of 69 purchase orders placed between July 2000 and February 2004, in 12 cases, the suppliers did not supply material worth Rs.4.37 crore. Audit analysis revealed that out of Rs.4.37 crore, material valued Rs.79.95 lakh was purchased later at a higher cost of Rs.1.40 crore, that although the cost and risk purchase clause was there in the purchase orders the same was not invoked and the Company levied penalty of Rs.2.10 lakh only and suffered a net loss of Rs.58.30 lakh. The company failed to safeguard its financial interest despite a specific provision in the purchase orders.

Government stated (August 2005) that in view of unprecedented fluctuation in steel price and severe shortage of steel, the competent committee took a decision to cancel the contract after recovery of penalty. The fact, however, remains that material was purchased at higher rates from other firms. The company should have invoked the risk & cost clause to avoid the loss. Views of Audit were also endorsed by Secretary (Energy) in the ARCPSE meeting (20 July 2005) by stating that risk and cost should be invoked otherwise there would be no sanctity of keeping the clause.

2.2.12 Non-action for removal/black listing/severing business relation from defaulter suppliers

To discourage the participation of defaulter firms in subsequent tenders, the purchase manual provides for severing of business relations with the defaulter suppliers. Audit analysis, however, revealed that in 19 out of 71 cases of Transmission Line division and in 15 out of 77 cases of steel division of RRVPNL, the suppliers /contractors did not supply full quantity of the material, but the company did not take any action for removal /severing business relation with these defaulters. Management of RRVPNL during the ARCPSE meeting stated that procedure in this regard existed but effective monitoring was not there. Government stated (August 2005) that subsequent order has not been placed on these firms. The reply is not correct as two firms were awarded orders despite default in earlier orders.

Non-documentation of transactions and events

The companies failed in ensuring documentation of transactions and maintenance of important records of stores.

2.2.13 The Stores manual prescribes systems for documentation of various stores transaction e.g. store keeping, store accounting and control measures such as register of authorised signatories to sign the indents, random physical verification, annual physical verification and preparation of list of slow/non moving items. It was, however, observed that the following important records as prescribed in stores manual were either not maintained or were not properly maintained.

2.2.14 Register for inquiries/tender notices

AVVNL and RRVUNL did not maintain the register of inquiries/ tender notices. RRVUNL also did not maintain required account for sale of tenders and tender receipt register. In the absence of these records, Audit could not assess the total number of tender forms sold and the revenue from sale of tender forms.

Government stated (July 2005) that now a register of tender inquiry had been opened for the tender forms issued to the firms and entries were being made in chronological order.

2.2.15 Estimate cards & Indents

The Estimate card shows the requirement of various materials for a specific work/job. The concerned sub division is required to bring this card, as and when any material is indented from the stores. The entry of stores issued is to be made in it by the stores officer.

The work identification memo (WIM) number should be mentioned on the indent. Superintending Engineer/Executive Engineer (SE/XEN) of the concerned circle shall intimate to Assistant Controller of Stores (ACOS) the names with specimen signatures of the officers authorised to indent stores. The stores manual prescribes a validity period of 10 days for an indent; in case material is not issued within validity period, the same is to be revalidated by the authorised signatory of the indent.

It was observed that:

- RRVPNL and JVVNL did not maintain Estimate cards of required material in the absence of which it could not be ascertained whether material issued against a work was in excess/short of the requirement.

- In none of the companies, had the SE/XEN of the circle concerned communicated the names and specimen signatures of the officers authorised to indent stores and the relevant register was also not maintained by ACOS. In absence of this, Audit could not verify whether the materials were issued to the authorised officers.

In RRVPNL, JVVNL, Jd.VVNL and AVVNL the materials were issued against the indents without showing the WIM number. The materials were also issued beyond validity period of 10 days without revalidation of indents. Further, most of the indents were undated, and it could not be ascertained in audit as to whether material were issued within the validity period of indents.

Government stated (August 2005) that necessary steps were being taken to implement the Estimate Card system and to evolve a complete system for signature verification on indents.

Monitoring and control over stores

2.2.16 Non-conducting of physical verification

The following violations of the provisions of the stores manuals were noticed during audit (January 2005):

Physical verification of stores was either not conducted or not conducted as per prescribed periodicity.

- The stores officers did not conduct random physical verification, except in JVVNL, during 2000-01 to 2004-05. The ACOS, Heerapura (RRVPNL) had also not prepared the list of items not issued during the last two years lying in the store. Slow-moving stores valued at Rs.55.41 lakh were lying in store since 1994.

- Periodical survey and inspection with a view to exercising proper control over the stores functions was not conducted in any company during the year 2001-05.

- Annual physical verification by stock verifiers was not conducted regularly in the stores in any of the Companies during 2001-05.

Government stated (August 2005) that periodical random physical verification, annual physical verification and periodical survey and inspection of stores had been initiated from the financial year 2004-05.

2.2.17 Non-adjustment of shortages and excesses

The excesses and shortages of stores items noticed during annual physical verification of stores should be cleared and adjusted within a reasonable period and at least by the close of the financial year. However, the shortages/ excesses during physical verification had not been cleared even after lapse of one to three years.

The companies failed to take remedial action on shortages/ excesses of stores.

The Company-wise position of excesses and shortages of stock included in inventory and remaining unadjusted as on 31 March of each year is tabulated below:-

(Amount:Rupees in lakh)

Name of the Company	2000-01		2001-02		2002-03		2003-04	
	Excesses	Shortages	Excesses	Shortages	Excesses	Shortages	Excesses	Shortages
RRVPNL	-	6.00	5.00	4.00	5.00	8.00	5.00	8.00
JVVNL	80.39	17.49	80.50	17.42	86.00	18.00	89.35	19.18

AVVNL	11.00	2.00	13.00	3.00	17.00	5.00	18.00	5.00
Jd.VVNL	49.00	23.00	49.00	20.00	57.00	23.00	67.00	24.00

It would be seen that no efforts were made to control the variations in stocks. Further in the absence of reconciliation/adjustment of shortages, the chances of recovery are remote.

Government stated (July/August 2005) that the matter was under review and adjustments/recovery was in progress.

Ineffective Management Control

2.2.18 For smooth functioning of an organisation management is required to prescribe and adhere to certain guidelines to effectively control advance payments and issue of material. It was observed that the companies did not prescribe specific time schedule for sending transformers for repairs, effective penal provisions to deal with delays, timely adjustment and recovery of advances and material issued to suppliers/fabricators. Due to non-prescribing of guidelines in this regard, companies could not effectively control the materials and advances given to contractors/fabricators. Deficiencies observed by Audit are discussed in the succeeding paragraphs.

2.2.19 Delay in sending failed transformers for repair

The power/distribution transformers that fail after the guarantee period, are either being got repaired by issuing work orders or being disposed off as scrap. The immediate repair of failed transformers within a reasonable period of time to recycle them for operation can reduce fresh purchase of transformers. No time limit for sending failed transformers from field to stores and for repairs had been prescribed in the stores manual. A period of three weeks (one week to send the damaged transformer from field to stores and two more weeks from stores to the repairer after joint inspection) may be considered a reasonable period for sending failed transformers to the repairer. Reconed by this yardstick, the Company-wise position of delays in sending failed transformers to stores and repairers during 2000-04 is tabulated below:

Name of the Company	Total failed transformers received in stores	Transformers test checked by audit	Delays in sending transformers (in days)	
			To stores	To repairer
JVVNL	252	44	22 to 1448	1 to 1427

AVVNL	388	100	10 to 515	Nil
Jd.VVNL	597	62	9 to 324	Nil

Delays in sending failed transformers valued Rs.3.04 crore from field to repairer ultimately resulted in purchase of new transformers.

The delays in sending 206 failed transformers from the field to the repairer resulted not only in transformers not being repaired available in time but also constituted an idle inventory of un-usable transformers valued Rs.3.04 crore.

It would be seen that the major delay was on the part of field officers; hence there is need to prescribe a time schedule for strict adherence by field officers.

Jd.VVNL stated (June 2005) that operations and maintenance (O&M) circle offices had been directed to send the failed transformers immediately to the concerned stores.

2.2.20 Delay in repair of transformers

The performance guarantee clause of purchase orders of distribution transformers stipulates that the transformers that fail within the guarantee period should be repaired/rectified by the supplier at his cost, within a maximum period of 45 days from the date of receipt of intimation of failure from the company. The supplier is required to submit a performance bank guarantee for an amount equivalent to five *per cent* of contract value towards satisfactory performance of transformers.

A review of the register of new transformers failing during the guarantee period maintained at ACOS revealed that transformers that failed during the guarantee period were lying with the supplier beyond 45 days for rectification of defects. The details of such transformers are given below:

Name of the Company	***Number of transformers***	***Value (Rs. in lakh)***	***Period (in months)***
JVVNL	35	12.55	6-66
AVVNL	49	10.93	10-40
Jd.VVNL	113	25.23	10-40

It was observed during audit that despite delays ranging from six to 66 months in repair of transformers the companies did not take action to recover the value of transformers from the available performance bank guarantee of the suppliers. As a result, funds of Rs.48.71 lakh remained blocked from 6 to 66 months.

Government stated (July 2005) that in case of JVVNL, 14 transformers had been received after repair and for the remaining 21 transformers, action was being initiated against the firms under various clauses of the purchase orders.

Jd.VVNL stated (July 2005) that vigorous efforts were being made to recover the amount of transformers from the suppliers.

2.2.21 Monitoring of Materials issued to contractors/fabricators and transfer within circle

Non-reconciliation/ adjustment of material valued Rs.4.19 crore shows lack of effective internal control over the issue of material to contractors/ fabricators.

The Companies issued raw materials like steel, cement etc. to contractors and fabricators for execution of works. It was observed in audit that materials valuing Rs.3.10 crore issued to contractors up to 2001-02 by AVVNL remained un-reconciled / unadjusted till 31 March 2004. Similarly, material-valuing Rs.1.09 crore issued to fabricators by JVVNL was lying unadjusted since 2000-01. The non-reconciliation/non-adjustment of the material shows lack of effective internal control over the issue of material to contractors/fabricators and the possibility of excess wastage or non-return of materials cannot be ruled out.

2.2.22 A review of the accounts revealed that in JVVNL this head of account showed a credit balance of Rs.43 lakh as on 31 March 2004. This shows that there is a lack of internal control in accounting of materials transferred from one unit to the other unit of the same circle.

Government stated (July 2005) that action was being taken to reconcile the same.

Advance payment to suppliers

2.2.23 The Companies make mobilization advance payments to contractors and suppliers. In RRVPNL, out of advances amounting to Rs.9.71 crore, a sum of Rs.8.16 crore (84.04 *per cent* of total outstanding) was pending against 70 suppliers/contractors since 1994-95 to 2000-01. As these outstanding amounts are very old and beyond the time of three years prescribed under the Limitation Act for filing a legal suit, chances of their recovery are remote.

Government stated (August 2005) that an amount of Rs.18.94 lakh had been adjusted/cleared during 2004-05 and efforts were being made to trace out the details of the remaining advances, which only proves that the company did not monitor the advances being given.

Internal Audit

2.2.24 Internal Audit is recognized as an independent appraisal activity within an organisation to examine and evaluate the activities of the organisation. Besides assisting in financial control, it is expected to help in the achievement of organisational objectives by improving the effectiveness of control and governance processes within the organisation.

Scope of Work

Internal audit coverage was inadequate, issuance of Inspection Reports were delayed and follow up was slack.

2.2.25 Internal Audit of Revenue and Expenditure of companies is conducted by the Internal Audit Wings headed by a Financial Advisor and Controller of Accounts (FA & COA) in all the five companies. All the companies follow the Internal Audit Manual (IAM) adopted by the erstwhile Board.

Poor coverage of units

2.2.26 As per IAM, expenditure audit for each office should be done once in a year. It was noticed during audit that the internal audit of the Material Management (MM) was not conducted in AVVNL and Jd.VVNL. In RRVPNL internal audit of SSPC[1] circle for the years 2000-04 & TLPC[*] circle for the years 2000-02 was conducted biannually instead of annually. It was further noticed that audit of SSPC and TLPC for the period 2000-02 was conducted belatedly in November 2003 and March 2004 respectively. In RRVUNL internal audit of MM wing at Kota Thermal Power Station was conducted for the years 2000-01 and 2002-03. The internal audit of MM Wing of Suratgarh Thermal Power Station was conducted for the year 2003-04 only. In JVVNL internal audit of all six units of MM Wing was conducted only for the year 2001-02 and thereafter no internal audit was conducted (March 2005).

Government stated (July/August 2005) that internal audit of MM Wing of AVVNL and Jd.VVNL had since been taken up. During the ARCPSE meeting Management of RRVPNL agreed to strengthen the Internal Audit set up.

Issue of Internal Audit Reports

2.2.27 The Internal Audit Manual prescribes that after the audit is over, the audit report should be sent to the concerned accounting unit seeking their compliance/replies but does not specify the time limit within which the internal audit wing should send the internal audit report to the concerned units. The Chief Controller of Accounts of RRVPNL also directed (July 2002) that

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1 SSPC: Sub-station Procurement Circle

* TLPC: Transmission Line Procurement Circle

reply to the memo should also be incorporated in Audit Report. It was, however, observed that in RRVPNL no internal audit report was issued during 2000-04.

In RRVUNL, the internal audit report of KTPS for the year 2002-03 had not been issued till date (July 2005).

Delay in settlement of paras

2.2.28 The effectiveness of Internal Audit largely depends on expeditious follow-up of Internal Audit Reports. The position of inspection reports and paras pending for settlement was as under:

	No. of Reports/Paras issued								No. of Reports/Paras outstanding							
Name of Company	**2000-01**		**2001-02**		**2002-03**		**2003-04**		**2000-01**		**2001-02**		**2002-03**		**2003-04**	
	IR	Paras	IR	Paras	IR	Paras	IR	Paras	IR	Paras	IR	Paras	IR	Paras	IR	Paras
RRVPNL	-	-	2	6	1	1	2	21	-	-	1	1	1	1	2	14
JVVNL	-	-	6	69	-	-	-	-	-	-	6	48	-	-	-	-
RRVUNL	1	8	-	-	-	-	1	8	1	8	-	-	-	-	1	6

The above table reveals that 57, 70, 87 *per cent* of paras issued are still pending for settlement in RRVPNL, JVVNL and RRVUNL respectively.

Follow up by the Board

2.2.29 The success of internal audit greatly depends on the supportive attitude and confidence reposed in this activity by the Board. The Internal Audit Manual stipulates that a six monthly summary of Internal Audit Reports should be put up to the Board of Directors for their perusal and directions. It was observed that in RRVPNL, RRVUNL and JVVNL summary of internal audit findings was not put up to the Board nor did the Board enquire about it. Government stated (June 2005) that in RRVPNL this had been started since January 2005.

Review of Internal Audit by Statutory Auditors

2.2.30 Statutory Auditors in their reports for the year 2001-02 to 2003-04 repeatedly pointed out that Internal Audit needed to be strengthened and streamlined in view of the size of the companies and nature of business but none of the companies had given due weightage to the Statutory Auditors report.

Audit Committee

2.2.31 In compliance of the provisions of Section 292-A of the Companies Act, the companies constituted (May/September 2001) Audit Committees (AC) with three members. According to the terms of reference, the Audit Committee were required to consider, discuss, review, formulate and submit their recommendation/ observations on internal audit reports, and internal control system in the company. In terms of Section 292-A of the Companies Act, 1956, the Audit Committee should also, *inter alia*, discuss with the Auditors about the internal control system to ensure compliance and adequacy in the operation of the companies. It was observed during audit that there were eight meetings of the committee up to 31 March 2004 in the case of RRVPNL, 13 meetings up to January 2005 in the case of AVVNL, 10 meetings up to September 2004 in the case of RRVUNL, 11 meetings up to April 2004 in case of JVVNL and 11 meetings up to September 2004 in the case of Jd.VVNL.

In none of the meetings were the prevailing internal control system and internal audit reports discussed with a view to ensuring their efficacy and adequacy.

Government stated (July 2005) that in case of Jd.VVNL, FA&COA of the company attended the Audit Committee Meeting held on 28 February 2005 and discussed the matter. The fact remains that though FA&COA attended the meeting, matters regarding material management and internal audit were not discussed. The Government also stated (July 2005) that in case of RRVPNL, AVVNL and Jd.VVNL, the progress report would henceforth be submitted to the Boards.

Conclusion

Internal control system in the five power sector companies was not effective as these companies failed to ensure compliance of the controls prescribed. The guiding principles/policies as prescribed in the Purchase and Stores Manuals with regard to purchases, quality assurance and maintenance of records were not followed in practice. None of the companies prepared separate 'material' budgets in the absence of which,

the reasons for variances between estimates and actuals could not be analysed.

The companies did not fix the minimum, maximum and reordering levels of stores and also did not use material management techniques like ABC value and movement analysis before finalisation of requirements. The Companies failed to adhere to the time schedules in finalisation and issue of purchase orders and implementing of the terms of the purchase orders. The companies did not have a regular programme of physical verification of inventories.

The companies failed to put in place a dependable system to investigate and settle cases of stores found short/excess/stolen. The companies did not prescribe time limits for sending failed transformers from field to store and for repair. Though the companies have Internal Audit Wings, the internal audit of material management wing was not conducted by AVVNL & Jd.VVNL. The Statutory Auditors had also pointed out the need to strengthen and streamline internal audit in view of the size and activities of the companies but none of the companies took any corrective action.

Recommendations

The Companies should:

- **Evolve a system to ensure compliance of the prescribed control procedures for material management.**
- **Evolve a system to prepare separate 'material' budgets with a view to plan future operations.**
- **Strengthen the system for timely finalisation of purchase orders to avoid inordinate delay in completion of works.**
- **Strengthen the system to recover the 'risk and cost' amount.**
- **Keep the store records as prescribed in the stores manual.**
- **Have an effective system for annual physical verification of inventories for all stores.**
- **Streamline the system of investigation to finalise the cases of stores found short/excess.**

- **Strengthen and streamline the internal audit wing in view of the size and nature of activities of the companies.**

- **Fix a time limit for sending transformers for repairs to avoid idling of equipment.**