

## **CHAPTER – VII**

### **INTERNAL CONTROL SYSTEM AND INTERNAL AUDIT ARRANGEMENT IN GOVERNMENT DEPARTMENTS**

#### **CO-OPERATION DEPARTMENT**

**7.1** Internal Control (IC) is an integral process that is effected by an entity's management and personnel and is designed to provide reasonable assurance that the following general objectives are achieved:

- Fulfilling accounting obligations;
- Complying with applicable laws and regulations;
- Executing orderly, ethical, economical, efficient and effective operations;
- Safeguarding resources against loss.

Thus, IC is an inherent part of the day to day management process (*i.e.* planning, directing and controlling) within a department/office. Internal Audit is a part of the Internal Control mechanism.

A performance Audit was conducted in April-May 2005 to gauge the efficiency of the IC system of the Co-operation Department. The results are enumerated in succeeding paragraphs.

#### **7.2 Introduction**

The Co-operation Department was formed with the objective to organise, register, promote and develop various types of Co-operative Societies in the State, conduct training, undertake and promote marketing of products, develop suitable infrastructure for such activities and ensure the success of cooperation movement in the State. The Department was responsible for inspection and audit of accounts of the Co-operative Societies at prescribed intervals and guide the societies in proper maintenance of accounts and carrying out the affairs of the societies strictly in accordance with the rules and orders of Government contained in 'Sikkim State Co-operative Societies Act, 1978' and 'Sikkim Co-operative Societies Rules, 1981' as amended from time to time.

In Sikkim, two – tier co-operative societies are functioning *i.e.* Apex Co-operative Societies (5) and Primary and Multi-purpose Co-operative Societies (540). While the management of affairs of Apex level societies was vested with Board of Directors, the respective Managing Committee was responsible for day to day management of the other societies. 361 out of 545 societies registered (since 1959) were functional as on 31 March 2005.

### 7.3 Scope of Audit

A Performance Audit on the 'Internal Control System including Internal Audit System' in the Co-operation Department for the years 2000 to 2005 was conducted in April-May 2005 with reference to the records maintained in the Office of the Secretary, Co-operation Department and Registrar, Co-operative Societies to assess whether necessary control mechanisms were appropriately prescribed, functional and adequate to enable the Department to fulfill the assigned objectives.

### 7.4 Audit methodology

The Performance Audit was carried out based on analysis of procedures existing in the Department as regards accounting, compliance with applicable laws and regulations, orderly, ethical, economical, efficient and effective execution of various activities/operations and safeguarding resources against loss.

Data and information provided by the Department in response to set of standard questionnaires issued by audit was analysed to obtain the specified results. Case studies of selected files and quantitative analysis of the results obtained through scrutiny during the course of audit was also adopted to obtain reliable and balanced status of 'Internal control System' in the Department.

### Audit findings

### 7.5 Budgetary Controls

The year wise provision and expenditure during the period under review were as under:

Table 7.1

(Rupees in lakh)

| Year         | Budget Provision |               |                 | Expenditure     | Savings<br>(% in brackets) | Amount<br>surrendered<br>during the year |
|--------------|------------------|---------------|-----------------|-----------------|----------------------------|--|
|              | Original         | Supplementary | Total           |                 |                            |  |
| 2000-01      | 650.23           | 120.00        | 770.23          | 745.48          | 24.75 (3)                  | 3.80 (15)                                |
| 2001-02      | 739.35           | 32.05         | 771.40          | 718.19          | 53.21 (7)                  | 51.83 (97)                               |
| 2002-03      | 433.71           | 1.93          | 435.64          | 420.78          | 14.86 (2)                  | 9.80 (66)                                |
| 2003-04      | 371.35           | 5.58          | 376.93          | 321.81          | 55.12 (15)                 | 54.27 (98)                               |
| 2004-05      | 516.65           | 175.00        | 691.65          | 675.37          | 16.28 (2)                  | 13.41 (82)                               |
| <b>Total</b> | <b>2,711.29</b>  | <b>334.56</b> | <b>3,045.85</b> | <b>2,881.63</b> | <b>164.22 (6)</b>          | <b>133.11 (81)</b>                       |

The figures within bracket indicated the percentage of actual surrender.

Source: Appropriation Accounts

Audit observed that the budgetary control was not up to the mark as savings were not anticipated in time and surrendered. Against the actual savings of Rs. 164.22 lakh during 2000-05, only Rs. 133.11 lakh were surrendered. The amount surrendered ranged between 15 and 98 per cent of the total savings of respective years. Supplementary provisions during the year 2001-02 to 2003-04 were unnecessary as the eventual expenditure during these periods did not come up to the original budget provisions. Persistent savings against the provisions and Department's inability to anticipate the same and surrender the funds in time, excess supplementary provisions etc. indicated improper budgeting and control over expenditure.

## 7.6 Operational Controls

### *Formation of Co-operative Societies-Target and achievement*

7.6.1 The Department planned to form 159 Co-operative Societies during the period 2000 to 2005 involving a total membership of 12,350. The Department achieved registration of 170 societies with a membership of 8,704 only.

Out of 170 new societies formed 33 societies became defunct within a short period of working. The total number of defunct societies was 184 (out of 545) as on March 2005 corresponding to 34 *per cent* on which an investment of Rs. 4.77 lakh was made by State Government. The increasing number of societies becoming defunct after running for a short period projected a dismal picture about the Department's ability to organise, administer, guide and control the cooperative societies. In addition, the assets of the defunct societies were not liquidated and the liabilities discharged.

The Department stated (July 2005) that closure of units of the co-operative societies was due to lack of managerial skill and leadership quality in members and office bearers and inadequate response from public. The Department, however, assured that serious steps were being taken by issuing strict instructions to district field functionaries to assess feasibility before registration of the new societies.

### *Audit Planning, Target and Coverage*

7.6.2 In terms of Section 64 of Sikkim Co-operative Societies Act, 1978, annual audit of each society is mandatory. For efficient and optimum utilisation of limited manpower and financial resources, audit planning is required to be prepared every year. This ensures coverage of all required units over a period of time, prioritisation of auditee units and finalisation of time schedule for audit and distribution of audit resources. Against the target of arrear audit of 1,427 society years during the period from 2000 to 2005, the Department could cover 863 society years (60 *per cent*) only.

The Department attributed (July 2005) the shortfall to shortage of staff, frequent changes of office bearers of societies leading to non maintenance of books of accounts and new societies remaining non-functional. The percentage of shortage in audit staff ranging between 13 and 23 *per cent* of the sanctioned strength, however, did not match with that of audit in arrears.

The Department did not maintain any Master Audit Programme Register to keep a watch over the events of any society becoming due for audit, periodicity of audit, conduct of audit, issue of Inspection Report etc. for ensuring effective audit planning. Department also did not assess the requirement of mandays for audit in any society depending on the volume and nature of transactions. Consequently, requirement of mandays or utilisation of staff engaged in audit was not assessable.

In reply, the Department informed (July 2005) that Master Audit Programme register has since been introduced.

***Non recovery of Audit fee***

7.6.3 Despite specific provision in the Sikkim Co-operative Societies Rules, 1981, the Department did not realise audit fee from the societies being audited by it on the plea of poor financial condition of the societies and instruction from Government. The Department, however, could not provide documentary evidence in support of Government's directives in this regard.

***Absence of follow-up-action on Audit Reports***

7.6.4 In terms of Rule 59(8) & (9) of Sikkim Co-operative Societies Rules, 1981, the summary of audit report of any society prepared by the auditor shall be read out in the next Annual General Meeting (AGM) following audit. If the result of audit held under the Rules discloses any defect in the working of the society, the society shall, within three months from the date of audit report explain to the Registrar the defects or the irregularities pointed out by the auditor and take steps to rectify the defects and remedy the irregularities and report to the Registrar.

The Department did not maintain records showing the number of audit reports sent to the societies since inception, closed after receipt of proper rectification reports and the number of reports awaiting settlement.

Scrutiny of 115 available files containing 261 Audit Reports for the period 1994 to 2005 revealed the following.

- There were several cases of unauthorised credit sales (Rs. 42.68 lakh), stock deficit (Rs. 5.08 lakh) and cash (Rs. 32.14 lakh) retained by office bearers which remained unaccounted in the books of accounts of the societies.
- There was no proper system for follow-up action through rectification reports. There was no reporting system of sub-divisional/ divisional level functionaries to the circle/ Apex level functionaries about the status of inspection/ audit.
- The audit of primary societies was being conducted at sub-division level by the Auditor/ Audit Officers and the audit reports were being sent to the management of the societies by the Additional Registrar of Co-operative Societies/ Deputy Registrar of Co-operative of the respective districts at the division level. No follow-up-action on the audit reports was being watched at the division level.
- As the audit reports were dealt with at the division level, the Registrar did not have any information on the follow-up-action of the audit reports. The Department was also not in a position to furnish the number of reports awaiting rectification and number of reports actually disposed of after receipt of action taken reports.

In reply, Department stated (July 2005) that committee would be constituted at district level to carry out effective follow-up-action after issue of Audit Report.

***Controls through Inspection of societies***

7.6.5 According to section 66 and 67 of the Sikkim Co-operative Societies Act, 1978 read with Rule 61 of Sikkim Co-operative Societies Rules, 1981 the Co-operative Inspectors have to inspect the societies every month and Inspection Reports are to be prepared which shall contain a column regarding the status of rectification report relating to the follow-up of Audit Reports. However, the existing system of inspection, preparation and follow up of Inspection Reports were yet to be reviewed and corrective measures evolved by the Department. Unless inspection reports were followed up for remedial measures, the very objective of societies being inspected gets frustrated.

In reply, the Department stated (July 2005) that the system has since been improved.

**7.7 Management Control**

***7.7.1 Functioning of societies***

The Government invested Rs. 9.61 crore towards share capital and substantial financial assistance by way of subsidy of Rs. 5.21 crore and loan of Rs. 0.23 crore during the last five years on the five Apex Co-operative institutions and other Co-operative societies. The extent of assistance and investment during the last five years was as under:

**Table -7.2**

*(Rupees in lakh)*

| <b>Year</b>  | <b>Assistance</b> | <b>Loan</b>  | <b>Investment</b> | <b>Return on investment</b> |
|--------------|-------------------|--------------|-------------------|-----------------------------|
| 2000-01      | 101.09 (121)      | NA           | 426.75 (101)      | 0.79                        |
| 2001-02      | 49.20 (74)        | 0.80 (2)     | 397.90 (62)       | 15.88                       |
| 2002-03      | 88.54 (270)       | 0.80 (2)     | 39.50 (30)        | Nil                         |
| 2003-04      | 22.62 (19)        | 2.00 (5)     | 31.80 (1)         | 0.08                        |
| 2004-05      | 259.55 (114)      | 19.00 (11)   | 65.00 (2)         | Nil                         |
| <b>Total</b> | <b>521.00</b>     | <b>22.60</b> | <b>960.95</b>     | <b>16.75</b>                |

*The figures within bracket indicate number of institutions/Societies.*

*Source: Departmental Figure*

Scrutiny of the records revealed the following.

- Against the Government investment in the primary cooperative societies, no share certificates were received in respect of West, North and South districts and that of East district was incomplete. Regarding the Apex societies, except Sikkim State Co-operative Bank Limited, the Department could not show all the share certificates/ copies of the same relevant to the investment.
- Huge financial assistance over the years in every field of activities was rendering the societies dependent on Government aid rather than making them self-reliant.
- No loan was repaid by the societies.
- No dividend, except from five societies to the tune of Rs. 19.48 lakh since inception, was paid to the Government as they were not making profit.

Department, in reply, stated (July 2005) that district offices had since been instructed to obtain share certificates in favour of Department for the money invested in different societies.

#### **7.7.2 Specific comments on five Apex Societies**

##### ***Sikkim State Co-operative Supply and Marketing Federation Ltd. (SIMFED)***

- The audit of the society was not conducted by the Department since 2000-01.
- No AGM was conducted by the society since June 2001.
- Against the Government's liability of Rs. 10 lakh towards the authorized capital of Rs. 12 lakh Government invested Rs. 1 crore till 31 March 2005. Such investment was beyond the provisions of the bylaws of the society. The authorized share capital was enhanced from Rs. 12 lakh to Rs. 1 crore vide Board's resolution (June 1997) and AGM (December 1997). The same was again enhanced to Rs. 3 crore vide AGM (June 2001). However, the relevant by-laws were not amended.
- The accumulated loss of the society as on 31 March 2003 was Rs.19.25 lakh despite profit of Rs. 32.34 lakh in 2001-02 and Rs.14.71 lakh in 2002-03.
- Share certificates for investment of Rs. 27.75 lakh were not obtained.

***Denzong Agriculture Co-operative Society Ltd. (DACs)***

- Against the liability of Rs. 22 lakh towards authorised share capital of Rs. 30 lakh, Government contributed Rs. 63.15 lakh till 31 March 2005.
- The society did not convene any AGM during the entire period of review of five years (since 5 July 1997).
- Against the investment of Rs. 63.15 lakh, no share certificates were obtained by the Department.
- The society was incurring losses during the entire period covered under review. The accumulated loss stood of Rs.82.96 lakh as on 31 March 2004.

***Sikkim State Co-operative Bank Limited (SISCO)***

- Against the requirement of Rs. 4.77 crore at 51 *per cent* of paid-up capital of Rs. 9.36 crore, the Government invested Rs. 8.94 crore at 96 *per cent* of paid-up capital. The Department did not furnish any reply for the higher investment.

***Sikkim Milk Union (SMU)***

- The society incurred losses persistently i.e., Rs.23.97 lakh in 2000-01, Rs.29.02 lakh in 2001-02, Rs. 44.99 lakh in 2002-03 and the net accumulated loss was Rs. 1.67 crore as on 31 March 2003. The information for the last two years was not available with the Department.
- Although audit of the society was completed by the departmental auditors till 2002-03, rectification report remained to be received since 1999-2000.

**7.7.3 Control over payment and recovery of loan**

The Department released (w.e.f. 1995) loans to the Multi Purpose Rural Co-operatives Societies (MPCS) and other Co-operative societies for various purposes at specified rate of interest as applicable from time to time, repayable after prescribed gestation period. Audit observed that the recovery of loans ranged between 0 and 3 *per cent* only during the period 2000 to 2005 and outstanding loans aggregated to Rs. 43.07 lakh as on 31 March 2005 as detailed below:

**Table -7.3**

*(Rupees in lakh)*

| Year    | Opening balance | Loan paid during the year | Recovered during the year | Closing balance |
|---------|-----------------|---------------------------|---------------------------|-----------------|
| 2000-01 | 29.69           | -                         | 0.84 (3)                  | 28.85           |
| 2001-02 | 28.85           | -                         | 0.17 (1)                  | 28.68           |
| 2002-03 | 28.68           | -                         | 0.10 (0)                  | 28.58           |
| 2003-04 | 28.58           | -                         | 0.49 (2)                  | 28.09           |
| 2004-05 | 28.09           | 15.00                     | 0.02 (0)                  | 43.07           |

Source: Finance Accounts

This indicated that efforts were wanting towards effective and timely recovery of loans.

**7.7.4 Control over receipt of share certificates**

The Co-operation Department was investing funds towards equity in various Co-operative Societies. The Department, however, did not maintain proper accounts of the investments and also did not obtain share certificates in all the cases from the management of those Co-operative societies. As against the investment of Rs. 12.62 crore as at the end of 2004-05 in various Apex and Primary co-operative societies, the Departmental records showed Rs. 9.61 crore (8.96 crore upto 2003-04 + Rs. 0.65 crore in 2004-05) only resulting in unexplained difference of Rs. 3.01 crore.

Further, the Department received 86 share certificates upto 31 March 2005 for Rs. 10.05 crore only against the investment of Rs. 12.62 crore of which six were incomplete as face value of share, date of issue etc. were not mentioned. The Department neither obtained share certificates for the balance amount of Rs. 3.22 crore nor could furnish details relating to the investments made.

In reply the Department stated (July 2005) that proper accounts of investment had since been maintained by the Department.

**7.8 Manpower Management**

7.8.1 The Department never prepared any individual job specification. Manpower requirements, quantum of work, output etc. were neither analysed nor prescribed and the overall deficiency or surplus in the deployment of staff was also never reviewed. There was no formal distribution of work and clear demarcation of functional responsibilities amongst departmental staff except in the cases of Inspector, Lower Division Clerk (LDC), Assistant Registrar, Deputy Registrar, Joint Registrar and Additional Registrar. There was excess /short deployment of personnel as detailed below:

**Table -7.4**

| Designation     | 2000-01   |           | 2001-02   |           | 2002-03   |           | 2003-04   |           | 2004-05   |           |
|-----------------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|
|                 | SS        | MIP       | SS        | MIP       | SS        | MIP       | SS        | MIP       | SS        | MIP       |
| Addl. Registrar | 2         | 0         | 2         | 1         | 2         | 1         | 2         | 1         | 2         | 1         |
| Audit Officer   | 8         | 7         | 10        | 8         | 10        | 8         | 10        | 17        | 10        | 15        |
| Auditor         | 17        | 15        | 17        | 15        | 17        | 15        | 17        | 3         | 17        | 8         |
| Inspector       | 36        | 25        | 36        | 28        | 36        | 28        | 36        | 25        | 36        | 22        |
| Jr. Accountant  | 1         | 3         | 1         | 3         | 1         | 3         | 1         | 3         | 1         | 3         |
| LDC             | 15        | 15        | 15        | 15        | 15        | 15        | 24        | 32        | 24        | 34        |
| Head Assistant  | 3         | 2         | 3         | 2         | 3         | 2         | 3         | 1         | 3         | 1         |
| Investigator    | 1         | 1         | 1         | 1         | 1         | 0         | 1         | 0         | 1         | 0         |
| <b>Total</b>    | <b>83</b> | <b>68</b> | <b>85</b> | <b>73</b> | <b>85</b> | <b>72</b> | <b>94</b> | <b>82</b> | <b>94</b> | <b>84</b> |

Source: Information furnished by the Department

SS = Sanctioned Strength

MIP = Men-in-Position



7.8.2 It would be seen that there was excess deployment of Audit Officers, Jr. Accountants and Lower Division Clerks while there were shortages in Additional Register, Auditors, Inspectors, Head Assistant and Investigator cadres indicating that the sanctioned strength was not in consistence with the work load and the deployment of manpower was improper and irrational.

In reply, the Department stated (July 2005) that unlike State (civil) Services, Co-operative cadre was constituted in 1994 only. Since promotions/ up-gradations were given in the past, depending on qualifying services rendered by the individual staff/ officer, excess/ shortage of manpower against sanctioned strength had occurred. The reply was not tenable as the Department should have reviewed the sanctioned strength periodically to suit these requirements.

### **7.9 Conclusion**

*Department was yet to evolve a proper system to assess exact requirement of funds resulting in persistent savings. Audit planning was ineffective due to absence of watch over societies becoming due for audit, mandays requirements, etc. Audit reports were dealt with at division level resulting in total lack of control by Registrar on follow up action. Investments in societies yielded paltry returns of less than two per cent. The apex Societies did not convene AGM regularly which affected Department's control over their activities. Efforts were wanting towards effective and timely recovery of loans which ranged between zero and three per cent. The deployment of manpower also lacked rationale.*

### **7.10 Recommendations**

After conducting Performance Audit on Internal Control System of the Department, the following recommendations were suggested for adoption which were accepted by the Department.

- Follow-up of inspection and audit reports has to be ensured for effective control over functioning of the societies.
- The issue of share certificates by the societies to the Department and its members has to be ensured.
- Duties and responsibilities of every functionary in the Department need to be specified in qualitative and quantitative terms with a view to ensuring effective internal control mechanism in all related matters.
- Before giving registration to any society, its future viability should be ensured.
- System should be evolved for closure and liquidation of defunct societies.

- Department needs to keep proper records relating to the financial assistances in the form of grants, investment, loan etc. to the societies since inception enabling the Department to know the stake of Government in any society at any given point.

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