

3.3 Internal Controls in Urban Local Bodies in Ernakulam District

Highlights

A built in internal control mechanism to ensure effectiveness in carrying out the traditional functions and the transferred functions by the Urban Local Bodies (ULBs) is provided in the Kerala Municipalities Act, 1994, rules made thereunder and Government Orders and guidelines. The internal control system in ULBs was very weak as rules regarding various control measures were not complied with. The system could not ensure efficiency and economy of operation and failed to provide reasonable assurance against loss and misappropriation.

- **Advances amounting to Rs.10.37 crore paid by the selected ULBs during 1975-76 to 2006-07 remained unadjusted as a result of control lapse.**

(Paragraph 3.3.7.5)

- **Non-adherence to internal controls prescribed in respect of assessment and collection of tax and non-tax revenue led to non-realisation of revenue.**

(Paragraph 3.3.9)

- **Non-maintenance of Personal Register led to lapse in internal controls for ensuring prompt action by the ULBs with respect to the documents received by them.**

(Paragraph 3.3.14)

- **Inadequate internal controls led to awarding the same work to a contractor as two different works in Municipal Corporation of Kochi (MCK)**

(Paragraph 3.3.16.1)

- **There was no provision in the Act and Rules for conducting internal audit to check the efficiency of the internal control system.**

(Paragraph 3.3.17)

3.3.1 Introduction

Kerala Municipality Act, 1994 (Act) governs the functioning of Urban Local Bodies (ULBs) consisting of five Municipal Corporations and 53 Municipalities. Apart from the traditional functions such as regulating building construction, collection and disposal of solid waste, management of public markets, maintenance of roads, street lighting, etc., certain functions of the Government as enumerated in the First Schedule to the Act *ibid* were transferred to the ULBs with effect from 2 October 1995. For carrying out the above functions and fulfilling the statutory obligations such as preparation of budget and accounts, taxation and finance, licences and fees, etc. the State Government framed several sets of rules. To ensure effectiveness in carrying out the above activities, a built in internal control mechanism in every ULB at all levels was absolutely essential. Specific internal control measures have been prescribed in the Act as well as in the Rules. Besides, Government has

also issued orders and guidelines from time to time to enable the LSGIs to have a strong internal control system. The creation of a control environment prevents and checks failure to adhere to rules and procedures laid down. Though one cannot eliminate completely the risks involved in a specified system by only following internal control measures, it is possible to mitigate the risks to a certain extent. Internal audit is a very important component of internal control and examines the effectiveness of internal control and recommends improvements. To ensure effective Internal Control, best practice requires a robust Internal Audit function complementary with other tools such as fraud controls, safety audit and programme evaluation.

3.3.2 Organisational set up

Mayor/Chairperson of a ULB elected by the Council is the Chief Executive Authority who has overall powers in all matters of administration of the ULB. There shall be five Standing Committees (Finance, Development, Welfare, Health Education and Works) in the Municipalities. In addition to these Standing Committees, the Municipal Corporations shall have two more Standing Committees for Town Planning and for Appeal relating to tax. The members of the standing committees are elected by the members of the council. Mayor/Chairperson shall be an ex-officio member in all standing committees and the Deputy Mayor/Deputy Chairperson shall be the ex-officio member and Chairperson of the Standing Committee for Finance. The standing committees oversee functions of ULBs in the respective spheres. The Secretary, who is an officer of the Government is the Executive Officer of the ULB.

3.3.3 Audit Objectives

The Audit objectives were to evaluate whether:

- the ULBs had properly complied with the internal controls prescribed in relevant Acts, Rules and Regulations
- records were properly maintained
- proper budgetary controls were exercised
- proper physical controls over assets were ensured
- control checks were exercised.

3.3.4 Audit criteria

Audit criteria used for the evaluation of control mechanism in ULBs were :

- (i) Provisions of Kerala Municipality Act 1994 and Rules there under
- (ii) Kerala Financial Code (KFC)
- (iii) Kerala Treasury Code (KTC)
- (iv) Manual of Office Procedure (MOP)
- (v) Orders and guidelines issued by Government

3.3.5 Audit methodology and scope

The review was conducted from April to July 2007, with reference to the records of one Municipal Corporation* and two Municipalities** out of nine ULBs in Ernakulam district. Evidences were gathered from the records, documents and registers maintained by the selected ULBs.

3.3.6 Audit findings

The audit findings are grouped under the following sections.

- (i) Observance of internal controls
- (ii) Adequacy of internal controls
- (iii) Internal audit
- (iv) Man power
- (v) Monitoring and evaluation

Observance of internal controls

Specific internal control measures were prescribed in the Kerala Municipality Act, KFC, KTC, MOP and orders and guidelines issued by the State Government. These controls intended to utilise the resources of ULBs in the best possible way avoiding risks of infructuous expenditure, loss, manipulations, mistakes, etc. thereby increasing the efficiency and performance standards of ULBs. However, the ULBs failed to implement the internal controls prescribed in the Act, Rules and Codes as discussed in succeeding paragraphs.

3.3.7 Financial controls

In the area of financial management, proper internal controls are prescribed in the Acts and Rules. However, prescribed internal controls were not observed in respect of custody and disbursement of cash and maintenance of cash book and other registers as detailed below:

3.3.7.1 Improper maintenance of cash book

According to Rule 92 (a) (ii) of KTC Vol I, all monetary transactions should be entered in a cash book as soon as they occur. However, the test checked ULBs maintained more than one cash book during 2002-03 to 2006-07 except in MMY during 2006-07 and none of them entered either the receipt or the remittance to bank on the day of transaction. None of the ULBs closed the cash book daily during the period 2002-03 to 2006-07, except MCK during 2005-06 and 2006-07. Improper maintenance of cash book indicated lack of control over the cash and bank/treasury balances of the local body.

3.3.7.2 Lack of control over custody and disbursement of cash

According to Kerala Municipal Corporation Accounts Rules, 1967, all disbursements were to be watched through a petty cash book. It was reported

Cash control was unsatisfactory.

* Municipal Corporation of Kochi (MCK)

** Kalamassery Municipality (KMY) and Muvattupuzha Municipality (MMY)

that Rs.5.41 lakh was lost on 6 December 2004 from the officer authorised to disburse pension to regular staff in MCK. However, the exact amount of loss could not be ascertained as the petty cash book was not written after 29 November 2004. Joint verification of cash balance in the custody of the officer in MCK who was responsible for disbursing pension to contingent staff, conducted on 20 July 2007 revealed a shortage of Rs.220. Even after this, MCK did not take any measure to prevent recurrence of such incidents like loss, shortage etc. by ensuring upto date closing of petty cash book and reconciliation of cash balance in the cash chest with the petty cash book balance.

3.3.7.3 *Subsidiary register for recording transactions pertaining to each treasury/bank account not maintained*

As the cash book had no separate columns for recording transactions pertaining to each treasury and bank accounts, balances relating to individual treasury/bank accounts were not ascertainable from the cash book. Though subsidiary registers for recording transactions pertaining to each treasury/bank accounts were to be maintained, the registers were maintained by none of the ULBs. Consequently, the details of balances in each of the treasury/bank accounts as per cash book were not available with the ULBs. Hence, reconciling the cash book balance and pass book balances at regular intervals was not possible and the occurrence of mistake/fraud remaining unnoticed could not be ruled out.

3.3.7.4 *Issue of Receipt books in bulk to the cashier*

Blank receipt books should be issued to the cashier who writes and issues the receipts only after completely exhausting the pages of the book already issued. However, scrutiny of stock register of receipt books maintained by MMY revealed that the receipt books were issued to the cashier in bulk. The risk of cashier using two receipt books at a time and misappropriating money received through one of the receipt books could not be eliminated. This control failure could lead to malpractices going undetected.

3.3.7.5 *Risk in non-adjustment of advances*

ULBs should adjust advances paid within one month in ordinary cases and three months in special cases. It was mandatory to close the Advance Register at regular intervals for regularising advances outstanding for periods exceeding the prescribed limit. As the Advance Register was not closed periodically, advances amounting to Rs.10.37 crore paid during the period from 1975-76 to 2006-07 by the ULBs remained unadjusted. Of this unadjusted advance, Rs.16.39 lakh drawn by three officials became irrecoverable as they retired from service. Due to control failure, the liability of the officers was not verified and assessed at the time of their retirement which resulted in non-adjustment of the advances paid to them.

Advance of Rs.10.37 crore remained unadjusted as advance register was not maintained properly.

3.3.8 Budgetary controls

The Act, clearly specified internal control measures for the preparation of budget in ULBs. Test check of the internal control system in the selected ULBs revealed the following lapses.

3.3.8.1 Delay in presenting budget before the council

The Finance Standing Committee was to prepare and lay the budget estimate for the ensuing year before the Council latest by the first week of March and the Council was to pass the budget on or before 31 March. However, Standing Committees in none of the ULBs test checked laid the budget before the Council in the first week of March. As a result of delayed presentation of budget, adequate time for consideration of the budget was not available to the Council. This led to approving of the budget without proper analysis and evaluation of the reasonableness of the budget proposals made by the Finance Standing Committee as it was mandatory to pass the budget on or before 31 March.

3.3.8.2 Expenditure in excess of budget provision

Except in the case of a pressing emergency, no sum shall be expended by or on behalf of a Municipality unless such sum is included in the budget estimates in force at the time of incurring the expenditure. The ULBs, test checked did not maintain the 'Register of Bills Passed for Payment' during 2002-03 to 2006-07 as prescribed in the Rules. In the absence of this register, expenditure control could not be achieved as a result of which the selected ULBs incurred expenditure of Rs.80.24 crore in excess of budget provision during 2002-03 to 2006-07 as shown below.

Three test checked ULBs incurred expenditure of Rs.80.24 crore in excess of budget provision as a result of budgetary control lapse.

(Rs in crore)

Year	Expenditure incurred in excess of budget provision							
	MCK		MMY		KMY		Total	
	No of items	Excess	No of items	Excess	No of items	Excess	No of items	Excess
2002-03	60	15.40	33	1.19	21	2.32	114	18.91
2003-04	53	17.05	40	0.99	22	1.42	115	19.46
2004-05	38	9.80	60	0.62	19	2.54	117	12.96
2005-06	41	24.13	Nil	Nil	NA	NA	41	24.13
2006-07	Nil	Nil	28	1.21	39	3.57	67	4.78
Total	192	66.38	161	4.01	101	9.85	454	80.24

3.3.9 Risks in assessment and collection of tax and non-tax revenue

Assessees escaped assessment of taxes due to non-observance of prescribed internal controls resulting in short realisation of revenue.

Effective and efficient internal controls were prescribed in the Act and Rules to mitigate the risks involved in assessment, levy, collection and accounting of different categories of taxes. Similarly, for proper and prompt collection of non-tax revenue, a definite system was prescribed in the Act and Rules. However, the ULBs did not adhere to the procedures prescribed for internal controls in this regard. The lapses in observing these controls resulted in assessee escaping assessment and levy of various categories of taxes and short collection of revenue as detailed in the table below:

Sl. No.	Area of control failure	Provisions of Act/Rules	Internal controls prescribed	Lapses in implementation	Risk not covered
1	Assessment of property tax on completion of building	Validity period of building permit is three years. Property tax should be assessed on completion of construction of building.	Building Permit Application Register indicating details of application, permit, completion certificate and occupancy certificate is to be maintained from which those who did not submit completion certificate can be identified and action taken.	Though the selected ULBs maintained the Building Permit Application Register, they did not monitor the completion of 871 out of 3896 buildings for which permits were issued three years ago.	Non-assessment of property tax on 871 buildings.
2	Assessment and recovery of profession tax of employees by the Head of the Institution	Every Head of office should assess profession tax of all the employees, recover the tax and remit to the ULB every half year.	ULBs were to issue notices to heads of offices/employers requiring them to assess and recover profession tax from their employees. Register of offices and institutions where persons are employed on salaries or wages is to be maintained by ULBs and the assessment watched.	37 to 327 Heads of Offices/employers did not collect and remit profession tax of their employees during 2002-03 to 2006-07 as the Register of offices and institutions was not properly maintained.	Non collection of profession tax. Arrears prior to 2003-04 became time barred.
3	Assessing Persons and Companies liable to be assessed to profession tax.	Secretary shall in the third month of every half year prepare an assessment list of persons or Companies and firms liable to be assessed to Profession tax	Notices were to be issued to traders to whom D&O licence was issued by ULBs for assessing profession tax.	Traders who obtained D&O licence for 2006-07 were not assessed to profession tax.	Short collection of profession tax.
4	Maintenance of profession tax arrear demand register	Arrear Demand Register of profession tax to be maintained for watching collection of arrears of profession tax.	Demand Register should be maintained showing demand, collection and balance of tax of each assessee. The balance at the end of each year was to be entered in the Arrear Demand Register.	MCK did not record the details in the Arrear Demand Register regarding arrears to be recovered during the period 2002-03 to 2006-07.	Non-realisation of arrears of tax.
5	Execution of agreement with allottees of shopping complex	For safeguarding the interest of ULBs, an agreement should be executed with the tenants before leasing out buildings.	An agreement register and rent register indicating details of agreement, rent realisable, etc. should be maintained.	Absence of proper maintenance of agreement register and rent register led to non-execution of agreements by KMY in respect of 12 rooms and 12 stalls leased out.	Non-realisation of rent from tenants.
6	Issue of Dangerous and Offence Trade (D&O) licence to traders/institutions	“No place within the Municipal area shall be used for any trade or business without a licence from ULB”. (Section 447 of KM Act)	Periodical inspection of premises of traders should be conducted to see whether they were trading with valid licences.	List of places used for trade and business under D&O licences was not kept by selected ULBs.	318 traders/institutions transacted business without valid D&O licence.

7	Registration of private hospitals and para medical institutions.	“No private hospital and para medical institution shall be established in the territorial area of municipality without prior registration in that municipality”. (Sec 311 KM Act)	When building permits are granted for construction of hospitals and para-medical institutions and occupancy certificate issued, it should be seen that they are registered in the ULBs. State Government framed Kerala Municipality (Registration of Private Hospitals and Private Para-Medical Institutions) Rules, 1997 governing registrations.	Periodical survey of institutions functioning in the ULBs should be conducted and list of institutions prepared to ensure that no private hospital/tutorial institution is functioning without registration. As the list of private hospitals and para medical institutions was not maintained, 75 private hospitals and para medical institutions which were assessed to profession tax for 2006-07 were not registered with ULBs.	Non-registration of 75 private hospitals.
8	Registration of tutorial institutions.	“No tutorial institution shall be established within a municipal area without prior registration obtained from that municipality” (Sec. 507 of KM Act)	When building permits are granted for educational institutions and occupancy certificates are issued, it should be seen that all tutorial institutions are registered with the ULBs. State Government framed Kerala Municipality (Registrations of Tutorial Institutions) Rules, 1999 governing registration.	ULBs did not maintain complete list of tutorials functioning in the area of ULB.	27 institutions functioning in the area of ULBs without registration – Loss of revenue.

3.3.10 Expenditure control

On a review of the expenditure incurred on unemployment wages and social security pensions, the following lapses were noticed in the implementation of internal control system.

3.3.10.1 *Non-adherence to prescribed internal controls by competent authorities*

According to orders issued (May 1998) by Government, unemployment wages are admissible to SSLC passed unemployed persons within the age group of 21 to 35 and whose family income is not more than Rs.12,000 per annum. However it was detected in audit that un-employment wages amounting to Rs.30760 were paid to 24 persons before attaining 21 years and to 20 persons after the age of 35 years in KMY and MMY. Though the date of birth and other details of the beneficiaries were available with the ULBs, the failure of the Secretary to ensure implementation of control measures led to enrolment

Unemployment wages and social security pensions were paid to ineligible persons as a result of flouting the relevant internal controls.

of underaged persons under the scheme and non-elimination of over aged persons resulting in payment of unemployment wages to ineligible persons.

The ULBs sanctioned social security pension such as widow pension, pension for disabled and mentally retarded persons and old age pension from 1997-98 onwards and Agricultural Workers Pension from 1998-99 onwards without fulfilling the control requirements. In MCK it was noticed that the Secretary did not certify the eligibility after proper scrutiny of the applications in 62 out of 100 applications for widow pension test checked whereas in KMY and MMY the Secretary did not scrutinise any application. As a result of this control failure, the risk of payment of widow pension to ineligible persons could not be overruled.

3.3.10.2 Pension sanctioning records not maintained

Various social security pensions are sanctioned, drawn and disbursed by the ULBs. In the ULBs test checked, such pensions were sanctioned to 6327 persons as detailed below:

SI No	Category of Pension	MCK		MMY		KMY		Total		
		No of Pensioners	No of applications and other documents available	No of Pensioners	No of applications and other documents available	No of Pensioners	No of applications and other documents available	No of Pensioners	No of applications and other documents available	No of cases where documents were not available
1	Widow pension	2109	1285	522	458	225	198	2856	1941	915
2	old age pension	965	869	110	69	110	92	1185	1030	155
3	pension to handicapped	1283	701	152	99	200	157	1635	957	678
4	Kerala Agricultural Workers Pension	130	80	142	82	379	338	651	500	151
	Total	4487	2935	926	708	914	785	6327	4428	1899

The documents such as application for pension, verification report, recommendation and decision in respect of 1899 out of 6327 cases were not available in the ULBs making further verification impossible. The risk of pensions being disbursed to ineligible persons could not therefore be safeguarded against.

The ULBs had to conduct annual verification to ensure that the pensioners continue to be eligible for pension. The ULBs test checked did not conduct such verification during 2002-03 to 2006-07. Thus, there was no assurance that the pension payments were restricted to eligible persons only.

3.3.11 Internal control in execution of works

Public works is a major area of operation of all ULBs. Hence implementation of internal controls prescribed was to be ensured without any exception.

3.3.11.1 Execution of works without essential records

ULBs did not record the chainage of roads/drains which was required for identification of the location of work site. On a test check of 50 works executed by each ULB, it was seen that more than 50 per cent of the works

50 per cent works were executed without preparing estimate reports/plans which may lead to overpayment and duplication.

were done even without preparing the estimate report/plans as envisaged in KPWD code. In the absence of the above details, the chances of unnecessary execution of works as well as overlapping and duplication of works could not be ruled out.

3.3.12 Accounting controls

Delay in preparation of annual financial statements indicated poor accountability.

3.3.12.1 Delay in preparation of Annual Financial Statement

The ULBs shall prepare and publish the Annual Financial Statement (AFS) for each year and the accounts so published shall be forwarded to the Director of Local Fund Audit before 31 July of succeeding year. However, KMY and MMY did not prepare the AFS for the years 2005-06 and 2006-07 as of August 2007. Thus internal controls prescribed for ensuring accountability of the ULBs could not be effected leading to risks of misappropriation, incurring expenditure in excess of budget provision, preparing budgets of subsequent years without considering the actual receipts and expenditure of previous years, etc.

3.3.12.2 Non-verification of original receipts issued

Revenue Inspector (RI) having jurisdiction of a division was to verify two *per cent* of original receipts granted to tax payers by the Bill Collectors with the respective counterfoils. A statement of verification should have been furnished by each RI to the Revenue Officer (RO) who should also check one *per cent* of original receipt not checked by RIs and furnish a certificate to that effect to the Secretary every month. However, no such verification was done in any of the ULBs test checked. In the absence of implementation of this internal control, possibilities of misappropriation could not be ruled out.

3.3.13 Physical control over assets

Physical control over assets was poor.

The ULBs did not maintain proper records for accounting of their assets such as land and buildings, furniture and equipment, etc. Annual physical verification of assets was also not done to protect them and to ascertain any loss or shortage. The control lapses detected in these areas were non-availability of details about landed property, non-verification of title deeds, etc. as detailed below.

3.3.13.1 Details of landed property not available

MCK maintained an asset register to record the details of land owned by it. However, the details incorporated in the register were collected through field visits conducted during 2005-06 and not based on relevant records. In the absence of reliable data on all the properties, there was no assurance that all the landed property owned by MCK was incorporated in the register and could be protected from unauthorised occupation and alienation.

3.3.13.2 Register for watching custody of title deeds not maintained

The ULBs test checked kept in their safe custody the title deeds of their immovable properties as well as properties pledged to them by others. KMY did not maintain a register for watching the custody of title deeds, whereas other two ULBs maintained the register which did not contain essential details such as survey number, area, etc, for linking the deeds with respective

properties. As a result the ULBs could not exercise physical control over assets.

3.3.13.3 Physical verification of immovable assets

None of the ULBs conducted Annual physical verification of title deeds of immovable properties owned by them and pledged to them. The Register maintained in MMY showed custody of 158 deeds against which only 132 deeds were available. In the absence of 26 out of 158 deeds, the risk of alienation/encroachment of properties could not be eliminated.

3.3.13.4 Physical verification of moveable assets

Though the test checked ULBs maintained the stock register of movable assets, they did not conduct annual physical verification during the period 2002-03 to 2006-07. As a result of this control failure, the risk of loss of movable assets could not be mitigated.

3.3.14 Administrative Controls

Non-maintenance of personal register led to lapse in internal controls.

The Manual of Office Procedure (MOP) prescribed various internal control measures for ensuring prompt action on letters/applications/complaints received by ULBs. On a test check, it was noticed that the procedure laid down in MOP was not followed by the ULBs. All letters received in ULBs were to be numbered and entered in the Distribution Register and then distributed to the clerks of the concerned sections. Clerks were to record the details of each letter in a Personal Register. The details of action taken was also to be noted in the Personal Register. Though the Distribution Register was maintained by every ULB, Personal Registers were not maintained in KMY. In MCK, 13 out of 113 clerks and in MMY two out of 17 clerks alone maintained Personal Registers. The Superintendent of General Section was to prepare a consolidated arrear report for the whole office for every month based on the arrear list furnished by each clerk and submit to the head of office on 10th of every month. However, the arrear report was not prepared in any ULB during the period from 2002-03 to 2006-07. In the absence of these control measures, the risk of not taking timely action on letters/applications/complaints could not be eliminated.

3.3.14.1 Separate record room not set up

According to MOP, old records should be kept in separate record room under the supervision of a record keeper for preserving them upto the stipulated period. However, no record room was set up in any of the ULBs test checked and no record keeper was posted in the ULBs except in MCK. This internal control lapse led to dumping of old records in the sections concerned involving the risk of destruction of records.

3.3.15 Other Controls

3.3.15.1 Non-maintenance of project register

The ULBs were to maintain a project register to record the details of each project undertaken by them. However none of the ULBs test checked except KMY and MMY during 2003-04 maintained this register during 2002-03 to 2006-07. In the absence of this register, details such as the amount allotted for

each project, expenditure incurred, whether project was completed, etc. could not be ascertained and the risk of expenditure exceeding allotment and non-completion of project could not be detected.

3.3.15.2 Non conducting of fuel efficiency test for vehicles

Fuel efficiency test of vehicles was to be conducted annually in order to achieve economy in fuel consumption. However, MCK tested only 16 out of 62 vehicles owned by them whereas none of the five vehicles owned by MMY was tested after 2004. As a result, the risk of consumption of more fuel than requirement could not be eliminated.

3.3.16 Adequacy of internal control

The internal controls prescribed in the Act and Rules should be adequate and sufficient to mitigate all kinds of risks involved in the day to day functioning of ULBs. The internal controls prescribed in the Acts and Rules were not adequate to mitigate the risks involved in the following areas.

3.3.16.1 Drain maps not prepared

In the absence of a system prescribed for the preparation of drain maps indicating all details of drains constructed and owned by ULBs, the sanctioning authorities could not ensure that no overlapping and duplication of works took place. During 2003-04, MCK executed two works viz.,

- (i) Repairing lane and drain and providing slab at Vathuruthy
- (ii) Construction of drain, covering slab and concreting lane at Vathuruthy.

Both the works were awarded (March 2003) to the same contractor who completed the work and claimed (September 2003) a total amount of Rs.8.44 lakh for both the works. The site plan of the works revealed that both the drain works executed related to the same drain existing at Vathuruthy. The measurement shown in the estimate as well as measurement book did not agree with actual measurement. In the absence of drain maps, the Corporation failed to rule out the possibility of overlapping and duplication in this case.

3.3.16.2 Inadequacy of internal controls led to payment of Rs.1.19 crore without any verification

Though ULBs arranged supply of drinking water in lorries through contractors in areas where water scarcity was experienced, there was no well defined internal control system to regulate payment in accordance with the quantity supplied. In the absence of such a system, the payment of Rs.1.19 crore to the contractors by MCK and KMY during 2002-03 to 2006-07 for supply of drinking water was made without properly verifying the quantity supplied by them as detailed below:

(Rupees in lakh)

Year	Expenditure incurred		
	MCK	KMY	Total
2002-03	Nil	4.17	4.17
2003-04	5.46	1.30	6.76
2004-05	18.16	4.52	22.68
2005-06	32.01	Nil	32.01
2006-07	52.95	0.29	53.24
Total	108.58	10.28	118.86

Inadequate internal controls led to awarding the same work to a contractor as two different works.

Though a register was maintained by the ULBs, no details regarding quantity of water supplied at each place were recorded. KMY did not even engage any officer to supervise the water supply. This control lapse occurred as a result of non-specification of an internal control system.

3.3.16.3 Pledging of fake security deposit receipts

Pledging of fake security deposit could not be detected due to inadequacy of internal controls.

Contractors were required to furnish security deposits to the LSGIs at prescribed rates at the time of execution of the agreement. They were permitted to pledge fixed deposit receipts and other deposit receipts as security deposit in lieu of cash deposits. However, there was no internal control system to ensure the genuineness of fixed deposit receipts produced by the contractors as security deposit. As a result, the fixed deposit receipts were accepted and kept in the custody of ULBs. On a verification of fixed deposit receipts made by Audit in MCK with reference to the records of institutions from where the contractors obtained the receipts, it was detected that three out of five deposit receipts having a total value of Rupees one lakh pledged by three contractors were fake. While permitting the contractors to pledge deposit receipts, no control measures were prescribed to ensure the genuineness of the receipts which led to the fraud. The matter was reported (July 2007) to MCK for detailed investigation on which no action was taken.

3.3.17 Internal Audit

There is no provision in the Act and rules for internal audit to evaluate the efficiency of internal controls.

The function of Internal Audit Wing includes examining, evaluating and monitoring the adequacy of accounting and internal control system. It also helps in assessing the organisational system and procedures in order to prevent fraud, errors etc. No provision was made in the Act for conducting internal audit. None of the ULBs test checked had such a system for detecting the lapses in internal controls, deficiency/absence of internal controls and reporting it to the ULBs and Government. The control failures enumerated in the preceding paragraphs were facilitated also as a result of absence of internal audit.

3.3.17.1 Performance Audit

Kerala Municipality (Manner of inspection and Audit System) Rules, 1997 envisaged a regular concurrent or running audit called Performance Audit by the State Performance Audit Officer at least once in a quarter in each ULB for detecting problems as and when they occur and solving them,. It was seen in audit that performance audit was not conducted in every quarter as detailed below.

Year	Number of Performance Audits due	Number of Performance Audits conducted		
		MCK	MMY	KMY
2002-03	4	1	1	1
2003-04	4	1	1	1
2004-05	4	2	1	2
2005-06	4	2	1	2
2006-07	4	Details not available		

The fact that performance audit was not conducted at prescribed intervals enhanced the risk of non-detection of problems.

3.3.18 Adequacy of Man Power

Manpower was not adequate to carry out the internal controls prescribed.

Government devolved upon the ULBs the functions, functionaries, institutions and schemes relating to matters enlisted in the Act with effect from 2 October 1995. Though the workload of the staff increased consequent on this change, no study was conducted to assess the same and the staff strength was not refixed. Though Government issued orders for deployment of staff from State Departments to LSGIs there was short deployment leading to inadequate discharge of functions by LSGIs as mentioned in paragraph 3.3.10 and 3.3.11 of the Report of CAG for the year ended 31 March 2006 (LSGIs). The shortage of staff in LSGIs weakened the internal controls as mentioned in this Chapter of this report.

3.3.19 Monitoring and Evaluation

3.3.19.1 Non-maintenance of Audit Objection Register

According to Article 63 of Kerala Financial Code Vol-I, in order to watch the progress in settlement of audit objections communicated by the Accountant General, an audit objection register shall be maintained in each office as a relevant internal control mechanism. However the three ULBs selected did not maintain this register during 2002-03 to 2006-07 leading to non-settlement of objections. The number of outstanding audit objections in respect of these ULBs was 267 as indicated in the table below.

SI No	Name of LSGI	No of pending Local Audit Reports	No of outstanding audit objections	Period	
				From	To
1	MCK	8	140	1997-98	2005-06
2	KMY	4	48	1997-98	2006-07
3	MMY	5	79	1997-98	2006-07
	Total	17	267		

This indicated the progress of settlement of outstanding objections was very poor.

3.3.19.2 Response to Audit

ULBs have to take remedial action on any defect or irregularity pointed out in audit. Audit Reports issued by the Director of Local Fund Audit (DLFA), State Performance Audit Officer (SPOA) and the Accountant General were to be placed before the Council for discussing observations contained in the reports. The ULB failed to place the reports before the Councils as detailed in the table below.

Name of LSGI	DLFA		Performance Audit		AG (Audit)	
	No of reports received during 2002-07	No of reports placed in the Council	No of reports received during 2002-07	No of reports placed in the Council	No of reports received during 2002-07	No of reports placed in the Council
MCK	2	0	5	3	4	2
KMY	1	1	5	1	2	1
MMY	0	0	4	1	3	1

Non-placement of audit reports before the Council prevented the Council from taking decision on the irregularities reported by DLFA, SPOA and AG.

3.3.20 Conclusion

The review of Internal Control System revealed that the control system was very weak and inadequate when compared to the size and nature of activities of ULBs. Rules, Regulations and Orders of Government regarding budgetary control, expenditure control, financial control and physical control were not complied with. The system could not provide reasonable assurance against the loss of resources and misappropriation of Government money. It could not ensure the economy and efficiency of operation including achievement of performance goals and safeguarding of resources against loss. There was no system for internal audit. Performance Audit was not conducted periodically. The response to Audit was also not satisfactory.

3.3.21 Recommendations

- Government and ULBs should take effective action for prescribing adequate internal control system wherever it was inadequate/absent.
- Government and ULBs should ensure that the prescribed internal controls are implemented by the ULBs.
- Internal audit wing should be formed in each ULB to evaluate the efficiency of internal controls as the performance audit is not a substitute to internal audit.
- Adequate manpower should be provided to exercise the prescribed internal controls.
- Government and ULBs should initiate action against those officers who violate internal controls.