

## CHAPTER – VII

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

#### PUBLIC HEALTH ENGINEERING DEPARTMENT

##### 7.1 Internal Control System in Public Health Engineering Department

*Internal Control (IC) is an integral process that is effected by an entity's management and personnel and is designed to provide reasonable assurance in achievement of the objective ethically, economically and efficiently. Internal Control is, thus broadly defined as a process effected by a department with reference to policies, plans, programmes, rules and regulations safeguarding the interest of the department and fulfillment of its objective.*

*Thus, internal control is an integral 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 system.*

*Evaluation of the internal control system in the PHED revealed deficiencies in budgetary control, stores management, inventory control and man power control. Non maintenance of basic records also affected the accuracy and completeness of the monthly accounts. Internal audit arrangements were also deficient and unable to provide assurance against financial irregularities.*

##### *Highlights*

*Supplementary provision of Rs.123.42 crore obtained by the department during 2000-05 when there was overall savings of Rs.132.88 crore during the same period indicated deficient budgetary control by the department.*

*(Paragraph 7.1.4)*

*There was overall savings of Rs.132.88 crore during the year 2000-05 and the department surrendered only Rs.109.98 crore. Thus, the financial discipline sought to be imposed through the General Financial Rules was ignored by the controlling officer of the department.*

*(Paragraph 7.1.5)*

*Irregular drawal of money by transfer credit to civil deposit/bankers cheques to avoid lapse of funds to the tune of Rs.15.08 crore resulted in erosion of legislative control over expenditure.*

*(Paragraph 7.1.6)*

*Extra expenditure of Rs.5.47 crore was incurred on salaries and wages of excess regular and workcharged staff.*

*(Paragraph 7.1.10)*

***Holding of excess stock of stores for Rs.32.84 crore over prescribed stock limit resulted in blocking of funds.***

***(Paragraph 7.1.12)***

### ***Introduction***

**7.1.1** Internal control is a system within an organisation that governs its activities to effectively achieve its objectives. A built-in internal control system and strict adherence to statutes, codes and manuals provide reasonable assurance to the department about compliance with applicable norms and rules thus achieving reliability of financial reporting and effectiveness and efficiency in departmental operations.

The Public Health Engineering Department is responsible for planning, constructing and maintaining of water sources and distribution networks for providing safe drinking water supply system, proper sanitary conditions to the people of the State, conservation of water source catchments and also creation of public awareness on public and personal hygiene.

### ***Audit coverage***

**7.1.2** A performance audit was conducted (November 2005) on the internal control system including internal audit arrangement in the Public Health Engineering Department (PHED) for the year 2000 to 2005. Test check was conducted in the office of the Chief Engineer (CE), PHED and two Divisions (Kohima and Dimapur) and the office of the Director of Treasuries and Accounts. The results of the test check are brought out in succeeding paragraphs.

### ***Audit objectives***

**7.1.3** The audit objective was to ascertain the adequacy of various internal control in the department, such as:

- financial controls
- administrative controls
- operational controls, and
- supervisory controls

## **Audit findings**

### ***Budgetary controls***

#### ***Provision of budget manual ignored***

**7.1.4** General Financial Rules 49 to 53, 65 and 73 envisaged adherence to budgetary controls, which *inter-alia* provided for the administrative departments to prepare budget estimates based on inputs from lower formations, spend within the budgeted amounts, avoid rush of expenditure at the close of the year and surrender the anticipated savings in time. Supplementary provision for funds was to be made only in case the original allotment proved insufficient. This required regular monitoring of monthly expenditure incurred by the Drawing and Disbursing Officers (DDOs) of sub-ordinate offices by the Directorate and by the Administrative Department.

The actual expenditure *vis-à-vis* budget provisions of the Department during 2000-05 were as follows:

**Table 7.1**

Year	Budget provision			Actual expenditure	Excess (+) Savings (-)
	Original	Supplementary	Total		
2000-01	52.34	33.71	86.05	61.71	(-) 24.34
2001-02	74.54	13.22	87.76	72.55	(-) 15.21
2002-03	67.22	54.46	121.68	93.08	(-) 28.60
2003-04	82.10	17.90	100.00	58.89	(-) 41.11
2004-05	81.13	4.13	85.26	61.64	(-) 23.62
<b>Total</b>	<b>357.33</b>	<b>123.42</b>	<b>480.75</b>	<b>347.87</b>	<b>(-) 132.88</b>

(Source: Appropriation Accounts)

From the table, it was apparent that failure to carry out regular monitoring as per the provisions of the General Financial Rule resulted in unnecessary supplementary provision of Rs.123.42 crore (2000-05) when the actual expenditure was less than the original budget provision itself resulting in savings of Rs.132.88 crore.

#### *Failure to surrender anticipatory savings in time*

**7.1.5** The GFRs provide that all anticipated savings are to be surrendered to the Government by 10 March of the financial year. Though the department had an overall savings of Rs.132.88 crore during 2000-05, only Rs.109.98 crore was surrendered. Thus, the financial discipline sought to be imposed through General Financial Rules was ignored by the controlling officer of the department.

#### *Irregular drawal of money to avoid lapse of funds*

**7.1.6** The Central Treasury Rules (CTR), 290 restrict the drawal of money from the treasury unless it is required for immediate disbursement. It was observed that during 2000-05, the Executive Engineer (EE), PHED, Kohima Division drew Rs.15.08 crore and credited the amount to civil deposit/bankers cheques to avoid lapse of the provisions under the capital head. This inflated the expenditure figures of the department during the years 2000-05. This irregular practice resulted in erosion of legislative control over expenditure, as the drawals from civil deposits/bankers cheques in subsequent years neither required further legislative approval nor was the expenditure incurred subject to legislative authority through the appropriation mechanism. Thus, using the facility of transfer credit from the consolidated fund to the civil deposit/bankers cheque violated the basic principles of legislative control over State finances.

#### *Expenditure controls*

##### *Rush of expenditure*

**7.1.7** Rush of expenditure in the month of March has the risk of the Government not getting proper value for money as the expenditure is likely to take place without due diligence. General Financial Rules required controlling officers to avoid rush of expenditure in the closing months by keeping a close watch on the progressive expenditure of the DDOs and the department as a whole on a month-to-month basis. However, it was seen that the department had incurred

97 per cent and 99 per cent of its total expenditure in March alone in 2003-04 and 2004-05, as detailed below:

**Table No. 7.2**

*(Rupees in crore)*

Year	No. of divisions	Total expenditure incurred during the year	Expenditure incurred in March	Percentage of total expenditure of the year in March
2003-04	11	Rs.67.90	Rs.66.51	97
2004-05	11	Rs.54.61	Rs.54.04	99

*(Source: Monthly account of PHE division)*

***Irregular booking of expenditure of Rs.1.15 crore***

**7.1.8** In March 2005 the Chief Engineer, PHED issued a supply order for an amount of Rs.1.16 crore for pipe fitting materials and galvanised mild steel tank to be supplied within 60 days from the date of issue of supply order. To avoid lapse of budget, the amount was drawn in March 2005 and sent on the same day to Executive Engineer, PHE Store Division, Dimapur. Test check of cash book of PHE Store Division revealed that the amount was shown as payment made on 31 March 2005. In reply (November 2005) the EE, PHE Store Division stated that, it was done only to incorporate the expenditure in the Divisional Accounts during financial year 2004-05. The payment was not made to the supplier as the materials are yet to be received and the money is kept in the department's Current Account. Thus, keeping the money in current account and booking of expenditure in the financial year without actually incurring it was irregular and violated financial rules and regulations and also inflated the total expenditure of the department during the year.

**Administrative controls**

***Quality in maintenance of records in the Directorate***

**7.1.9** Test check of the records (2000-05) of Chief Engineer, PHE (Directorate) revealed that important records like allotment register and compilation register of monthly expenditure of the entire Department on the basis of monthly expenditure statements received from lower formations were not maintained properly.

***Extra expenditure of Rs.5.47 crore on salary and wages of excess regular and workcharged staff***

**7.1.10** The Department of PHE had no mechanism to ascertain the actual requirement of staff under each category of post and had not developed yardsticks/norms to assess requirement of manpower for the various types of works. During 2003-04 and 2004-05 the department had 1,561 regular staff against the sanctioned posts of 1,153, which resulted in employment of excess manpower of 408 involving an extra expenditure of Rs.3.55 crore on salaries and wages. Similarly, during 2003-04 and 2004-05, against the requirement of 2,000 workcharged employees the department employed 3,433 workcharged employees during 2003-04 and 2697 during 2004-05 resulting in extra expenditure of Rs.1.92 crore on salaries and wages.

<b>Operational controls</b>
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***Irregular booking of funds of Rs.10.96 crore***

**7.1.11** As per instruction of Government, all funds of the department are allotted to the EE, (PHE) Kohima. Accordingly funds are drawn by the Kohima Division and subsequently distributed to different divisions on receipt of instruction from the CE, PHED. The EE, (PHE), Kohima sent six bank drafts for an amount of Rs.10.96 crore pertaining to 2004-05 financial year to the Store Division, Dimapur in the month of April 2005. Scrutiny of the cash book and monthly account of EE, PHE Store Division, Dimapur, for the month of March 2005 revealed that the above amount was received during April 2005 but was accounted for in the cash book as well as in the monthly account in March 2005. This indicates that the cash book was not maintained properly resulting in non-existence of financial discipline and regularity in the department.

<b>Supervisory controls</b>
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***Blocking of Government funds of Rs.32.84 crore***

**7.1.12** As per order (1982) of the Chief Engineer, Public Health Engineering the total Reserve Stock Limit (RSL) of stores fixed for eleven PHE divisions was Rs.90 lakh. But as per closing stock balance of stores as on September 2004, the total stock balance of stores of all the eleven divisions was Rs.33.74 crore. Thus, the divisions were holding excess stock of stores of Rs.32.84 crore as on September 2004, over sanctioned Reserve Stock Limit, which resulted in blocking of Government funds.

***Minus closing stock balance***

**7.1.13** Scrutiny of yearly stock ledger/returns and other relevant records of the PHE Store Division revealed that huge minus balances were reflected in the yearly stock account of water supply fitting materials, galvanized iron pipes, galvanized mild steel tank etc. details as shown below:

**Table No. 7.3***(Rupees in lakh)*

Year	Opening balance	Procurement	Issue	Closing balance
2000-01	21.87	693.75	529.74	185.88
2001-02	185.88	1130.60	1590.68	(-) 274.20
2002-03	(-) 274.20	2065.42	2398.49	(-) 607.27
2003-04	(-) 607.27	3174.08	3922.33	(-) 1355.52
2004-05	(-) 1355.52	2525.94	2374.43	(-) 1204.01

*(Source : Departmental figures)*

From the above table it would be seen that at the end of 2004-05, minus balance of Rs.12.04 crore was reflected in the stock ledger/returns. These minus balances were mainly attributable to (i) non adjustment of inter-divisional transactions, (ii) fictitious adjustment of stores and stock and (iii) non adjustment of profit/loss on stores and non revision of issue rates. This indicates absence of proper monitoring of the stores and stocks records.

### ***Internal audit***

**7.1.14** Internal audit, as an independent entity within or outside the department, is to examine and evaluate the level of compliance to the rules and procedures so as to provide independent assurance to senior management on the adequacy of the risk management and internal control framework in the department.

The scope of audit includes check of receipts and expenditure, compliance with laws and regulations and the propriety of expenditure in the subordinate offices of the department. The audit process, which consists of planning, execution, issue of reports and their follow-up is to be codified in an 'Audit Manual'.

The department did not have any Internal Audit wing. Director of Treasuries and Accounts (Audit wing) under Finance Department of the Government was entrusted with conducting internal audit of all Government Department. However, it was noticed that no internal audit of PHE Department had been conducted during the period covered by the review. Reasons for non-conducting of internal audit of PHE Department were not stated by the Director, Treasuries and Accounts.

### ***Lack of response to Audit***

**7.1.15** Accountant General (Audit), Nagaland conducts periodic inspection of Government transactions and the audit findings are communicated through Inspection Reports (IRs) to the Head of the Offices/Departments which are required to be complied within a specified period. A half yearly report on the pending Inspections Reports is also sent to each department to facilitate monitoring and compliance of audit observations.

As on April 2005, 883 paragraphs (Rs.278.41 crore) relating to 75 IRs of the PHED issued upto April 2005 were still pending. Of these, 391 paragraphs (43 *per cent*) relating to 40 IRs (52 *per cent*) were more than 10 years old. Failure to comply with the issues raised by Audit facilitated the continuation of serious financial irregularities and loss to the Government.

### ***Conclusion***

**7.1.16** Internal controls were ineffective in the PHED. The basic checks such as proper maintenance of cash book, timely submission of reports and returns, regular rendering of monthly accounts etc. were disregarded. The failure to observe internal control procedures has increased the risk of misappropriation and fraud taking place and remaining unnoticed. No efforts either to set right the system or to take action against the erring officials were evident. The department was not serious in implementing rules and regulations and failed to submit progress reports/monthly accounts in time.

**Recommendations**

**7.1.17** The following recommendations are made:

- Expenditure needs to be regularly monitored to avoid excess/savings from the budgeted figures.
- Irregular practice of drawal of money by transfer credit to civil deposit/bankers cheque should be discontinued.
- Expenditure should be incurred uniformly through out the year rather than at the end of the year.
- Steps need to be taken to adjust the inter-divisional transactions, fictitious adjustment and non adjustment of profit/loss of stores.
- Internal audit coverage of the auditee units should be planned in such a manner that all units are covered in a cycle of one to three years.
- Government should revamp the system of response to the audit observations pointed out in Inspection Reports of the Accountant General (Audit) to ensure timely response to the observations made.

The matter was reported to the Government and the Department in October 2005; their replies are awaited (November 2005).

**Kohima  
The**

**(RAM MOHAN JOHRI)  
Accountant General (Audit), Nagaland**

**Countersigned**

**New Delhi  
The**

**(VIJAYENDRA N. KAUL)  
Comptroller and Auditor General of India**