

## CHAPTER-V

### INTERNAL CONTROL SYSTEM AND INTERNAL AUDIT

#### TRANSPORT AND COMMUNICATION DEPARTMENT

##### 5.1 Internal Control System in Transport and Communication Department

*Internal Control is an integral process for the efficient discharge of an organisation's functions. It is a system designed to provide reasonable assurance for the achievement of the organizational objectives economically, efficiently and effectively. Evaluation of internal control mechanism in the Transport and Communication Department revealed deficiencies in budgetary, administrative, accounting, operational and monitoring controls. Internal audit arrangements were also deficient and unable to provide assurance against financial irregularities.*

##### *Highlights*

*Lack of effective budgetary control was characterized by inadequate monitoring and control of expenditure resulting in rush of expenditure in the last quarter of the financial year.*

*(Paragraph 5.1.8)*

*Laxity in financial control led to accumulation of heavy cash balances.*

*(Paragraph 5.1.9)*

*Due to non-preparation of pro-forma accounts, the commercial performance of the Nagaland State Transport could not be ascertained.*

*(Paragraph 5.1.12)*

*Surprise physical verification of cash balance was not carried out in the Department and its subordinate offices.*

*(Paragraph 5.1.13)*

##### **5.1.1 Introduction**

Internal control is an integral process which is designed to provide reasonable assurance to the Department about compliance with applicable policies, norms and rules for achieving reliability of financial reporting and efficiency in Departmental operations.

The main activities of the Transport and Communication Department are:

- To provide reliable, well co-ordinated and affordable transport service to the public;
- Registration and licensing of motor vehicles, issue of permits and revenue collection; and
- Maintenance of all Government vehicles used by Ministers, senior officers in the Secretariat and visiting dignitaries in the State.

#### **5.1.2 Audit objectives**

The audit objective was to ascertain the adequacy of various internal controls in the Department, such as:

- Financial controls
- Administrative controls
- Accounting controls
- Operational controls, and
- Monitoring controls

#### **5.1.3 Audit criteria**

The criteria used to assess the internal controls were:

- Internal control system prescribed by the Department
- Internal audit arrangements in the Department
- Provisions prescribed in the General Financial Rules

#### **5.1.4 Audit coverage**

A performance review of the internal control system including internal audit arrangement in the Transport and Communication Department for the period from 2001 to 2006 was conducted in August 2006. Test check of records was conducted in the office of the Commissioner, Transport and Communication (Kohima), General Manager Nagaland State Transport (NST) Department (Dimapur) and the office of the Director of Treasuries and Accounts (Kohima) covering an expenditure of Rs.123.51 crore (81 *per cent*) out of the total expenditure of Rs.153.26 crore. Two districts (Kohima and Dimapur) were covered out of the 11 districts in the State.

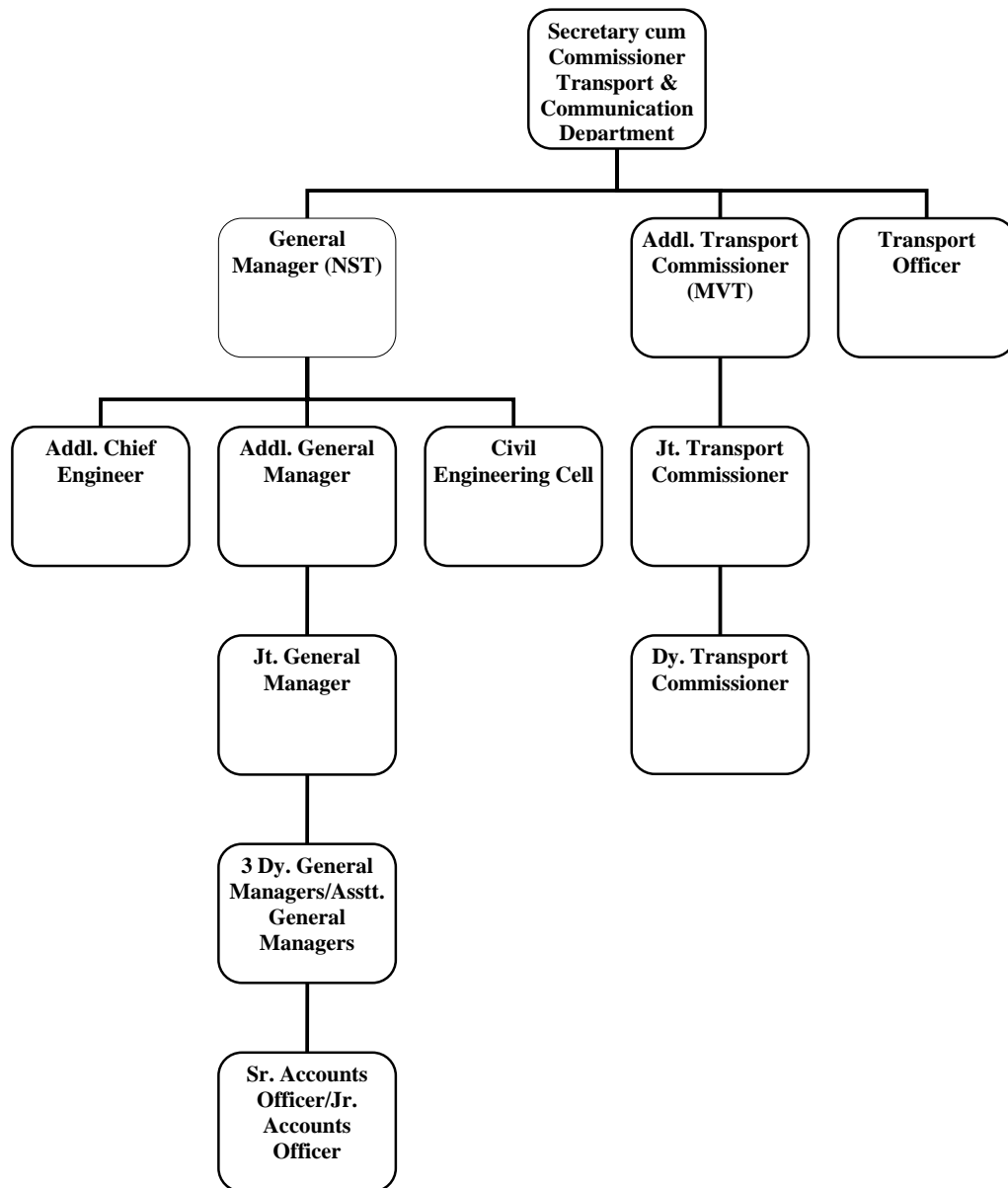
#### **5.1.5 Audit Methodology**

The data, information etc. collected from the office of the General Manager, Nagaland State Transport, Dimapur, Transport Commissioner, Motor Vehicles Department, Kohima and Secretariat Pool, Kohima were analysed and results thereof are incorporated in the form of audit findings.

An exit conference was held on 27 November 2006 which was attended by the Secretary and other officers. The audit observations were discussed and finalised after incorporating the views of the Government which are brought out in the succeeding Paragraphs.

**5.1.6 Organisational setup**

The Commissioner-cum-Secretary, Department of Transport and Communication is the administrative head of the organisation. The Department consists of three wings as indicated below in the organisational chart:



**Audit findings**

**5.1.7 Financial controls**

The funds allocated to and the expenditure incurred by the Department during 2001-02 to 2005-06 were as under:

**Table.5.1.1**

*(Rupees in crore)*

Year	Wings of the Department	Budget provision	Expenditure	Excess(+) Savings(-)
2001-02	NST	20.14	20.35	(+) 0.21
	MVT	1.86	1.81	(-)0.05
	Pool	3.53	3.49	(-)0.04
2002-03	NST	24.89	25.11	(+)0.22
	MVT	2.00	1.64	(-)0.36
	Pool	6.29	6.29	---
2003-04	NST	25.14	25.61	(+)0.47
	MVT	4.09	2.87	(-)1.22
	Pool	4.72	4.73	(+)0.01
2004-05	NST	22.60	22.60	---
	MVT	2.91	2.89	(-)0.02
	Pool	3.26	3.28	(+)0.02
2005-06	NST	25.04	25.03	(-)0.01
	MVT	2.93	2.80	(-)0.13
	Pool	4.81	4.76	(-)0.05
<b>Total</b>		<b>154.21</b>	<b>153.26</b>	

*(Source: Departmental figures)*

It can be seen that there was excess expenditure over the budget provision during the years 2001-02 to 2003-04 in respect of NST. The reason stated by the Additional General Manager (March 2005) was that while budget provision remained static since 2001-02, escalation in cost of all items year to year necessitated excess expenditure vis-à-vis budget provision.

**5.1.8 Rush of expenditure**

Rule 69 of GFR provides that rush of expenditure particularly in the last quarter of the financial year shall be regarded as a financial irregularity and should be avoided. The Union Ministry of Finance has also emphasised that under an effective cash management system, not more than 33 per cent of the budget should be utilised during the last quarter. The flow of expenditure during the financial years 2002-06 was as under:

Table 5.1.2

Year	Wing	Total expenditure	Expenditure (Rupees in crore)				
			April to December	January	February	March	Total (5+6+7)
			(Figures in brackets indicate percentage of expenditure)				
1	2	3	4	5	6	7	8
2001-02	NST	20.35	12.88 (63)	2.17	1.37	3.93 (19)	7.47 (37)
	MVT	1.81	0.96 (54)	0.10	0.10	0.64 (35)	0.84(46)
	Pool	3.49	1.17 (34)	1.10	---	1.21 (35)	2.31(66)
2002-03	NST	25.11	12.57 (50)	0.91	0.93	10.70 (43)	12.54(50)
	MVT	1.64	1.05 (64)	0.14	0.12	0.34 (21)	0.60(36)
	Pool	6.29	2.59(41)	0.01	---	3.70 (59)	3.71(59)
2003-04	NST	25.61	14.31 (56)	1.28	4.60	5.42 (21)	11.30(44)
	MVT	2.87	1.21 (42)	0.12	0.15	1.39 (48)	1.66(58)
	Pool	4.73	4.00 (85)	0.02	0.02	0.69 (14)	0.73(15)
2004-05	NST	22.60	10.83 (48)	0.91	1.45	9.40 (42)	11.76(52)
	MVT	2.89	1.30 (45)	0.13	0.15	1.31 (45)	1.59(55)
	Pool	3.28	3.07 (94)	---	0.01	0.20 (06)	0.21(06)
2005-06	NST	25.03	14.16 (57)	1.06	2.17	7.64 (31)	10.87(43)
	MVT	2.80	1.52 (55)	0.20	0.25	0.82 (29)	1.27(45)
	Pool	4.76	3.62 (76)	---	0.07	1.07 (22)	1.14 (24)

(Source: Departmental figures)

The above table shows that expenditure ranging between 37 to 52 per cent (NST) and 36 to 58 per cent (MVT) of the total expenditure was incurred in the last quarter during the years 2001-02 to 2005-06. Further, it was noticed that expenditure ranging between 19 to 43 per cent (NST) and 21 to 48 per cent (MVT) was incurred in March alone each year. This is indicative of lack of effective financial control and violation of GFR.

### 5.1.9 Laxity in cash management

As per Rule 290 of the Central Treasury Rules (Vol. I) no money shall be drawn from the treasury unless it is required for immediate disbursement. It is not permissible to draw money from Government account in anticipation of demands to avoid lapse of budget grants.

Scrutiny of cash book revealed that an average, closing cash balance of Rs.2 crore (NST) and Rs.0.30 crore (MVT) was maintained by the Department respectively. It was also noticed that analysis of the closing cash balance was never carried out. The retention of heavy cash balance in chest is fraught with the risk of misutilisation and misappropriation of cash. The Department had not taken any remedial measures to avoid retention of huge cash balances by the sub-ordinate offices.

Mention was made in Para 3.2.26 of the Report of the Comptroller and Auditor General of India, Government of Nagaland for the year 2004-05, regarding misappropriation of cash of Rs.9.95 lakh by the cashier of the NST. In reply, the Department stated (November 2006) that an amount of Rs.3.54

lakh has been recovered and the balance amount is in the process of being recovered.

## **Administrative controls**

### **5.1.10 Bill Register**

As per Rule 34 (Note 1) of Receipt and Payment Rules, Bill Register is to be maintained by all Heads of Offices who are authorised to draw money on bills signed by them. The register should be reviewed monthly by a competent authority and the result of the review should be recorded therein to prevent presentation of fraudulent bills for payment. Scrutiny of records revealed that though the bill register had been maintained, it had never been reviewed by any competent authority as prescribed by rules. Thus, the risk of non detection of fraudulent bills as well as non-settlement of outstanding bills in time has not been addressed by the Department.

The Department stated (November 2006) that directions has been issued to all the subordinate offices for regular review of the bill registers.

### **5.1.11 Stock register of receipt books**

As per Rules 22 to 24 of Receipt and Payment Rules, stock accounts of receipt books should be maintained and the closing balance in the stock account should be verified by the Head of office periodically and certificate to that effect recorded in the stock register. However, it was noticed that no verification was done and recorded in the stock register. Thus, due to the failure of the Department to conduct periodical physical verification of stock, the extent of shortage/excess could not be ascertained in audit. Moreover, this being a key ingredient of control, its non-observance can lead to pilferage and shortages.

The Department stated (November 2006) that necessary instructions has been issued to the concerned officers.

## **Accounting controls**

Accounting controls are designed and operated in a manner to ensure timely preparation of monthly/periodical returns and accounts by regular maintenance and updation of registers, documents and basic records.

### **5.1.12 Non maintenance of Proforma Accounts**

When the operations of a Department include undertaking of a commercial or quasi-commercial character and the nature and scope of the activities of the undertaking are such, as cannot be suitably brought within the normal system

of Government account, the head of the undertaking is required to maintain pro-forma accounts in commercial form.

Mention was made in Para 3.2.7 of the Report of the Comptroller and Auditor General of India, Government of Nagaland for the year 2004-05, regarding non-preparation of Proforma accounts.

It was noticed that the Department (NST) had not prepared any Proforma accounts from 1988 onwards and in the absence of timely finalization of Proforma accounts, corrective measures, if any, required could not be taken.

The Government stated (November 2006) that a Chartered Accountant has been engaged to prepare the *proforma* accounts.

#### **5.1.13 Surprise physical verification of cash balances**

Frequent surprise checks of cash balance are an effective control tool to minimize the possibility of embezzlement. Surprise physical verification of cash balance is required to be carried out periodically by any competent officer other than the DDO and Head of office. A certificate to the effect that the cash balance found during physical verification tallies with the closing balance is required to be recorded in the cash book. Non-observance of this control renders the Department vulnerable to misappropriation of Public funds.

Test check (August 2006) revealed that the Department had not conducted surprise physical verification of cash balances during the period covered under review.

### **Operational controls**

Operational controls are enforced through presenting and enforcing office procedure/manual or any financial manual which provides guidelines to the officials in respect of their specific duties to be carried out. The manual also helps the Head of Office/Departments as a tool of administrative/operational control. Deficiencies in operational controls are described below:

#### **5.1.14 Tyre retreading plant (NST)**

Mention was made in Para 3.2.29 of the Report of the Comptroller and Auditor General of India, Government of Nagaland for the year 2004-05, regarding non-functioning of tyre retreading plant. The Department did not take any remedial action to revitalize its own tyre retreading plant, instead, used tyres are being re-treaded in private workshops at much higher rates. Non operation of Departmental tyre re-treading plant resulted in excess expenditure of Rs.46.88 lakh during the last five years ending March 2006.

#### **5.1.15 Route analysis**

Routes have to be sanctioned based on their economic viability. The Department did not conduct any survey to assess the occupancy ratio and its viability before operating any new routes. A comprehensive review on performance of NST had indicated a large number of unviable routes resulting in reduction in overall occupancy ratio.

#### **5.1.16 Fleet utilisation**

The Department had not fixed any norm regarding fleet utilisation. The fleet utilisation was too low in comparison with all India norms. Due to low fleet utilization there was adverse affect on vehicle productivity of the Department. A review included in the Audit Report 2004-05 pointed out huge losses to NST due to low fleet utilisation.

#### **5.1.17 Tariff revision**

Section 67 of the Motor Vehicles Act 1988 empowers the State Government to fix the rate of fares from time to time for its buses. The State Government revises the tariff based on the proposals submitted by the Department. Test check revealed that no system was in place for updating the cost structure and its linkage with tariff structure. These has resulted in huge losses to the Department as detailed in the review of NST included in the Audit Report 2004-05.

#### **5.1.18 Cancellation of scheduled trips**

To provide timely transportation service, Directorate, NST is required to maintain the records of time schedule, total number of trips and also cancellation of trips, if any, to watch proper transportation services.

It was noticed that the Directorate, NST did not maintain any records regarding the number of cancelled trips. Non maintenance of details regarding number of cancellation of services indicates poor monitoring control of the Department.

#### **5.1.19 Non revision of Composite tax**

As per Section 4 of Nagaland Motor Vehicle Taxation Act, 1967 read with Section 3 and entry No. IX of Part B of the schedule appended thereof, State Government is empowered to fix the rate of composite tax for tourist cabs, coaches belonging to another State or Union territory which are authorised to ply in the State of Nagaland.

The Government of Nagaland in its notification (December 1993) laid down the rate of Composite tax. The Composite tax had not been revised and updated for the last 13 years. A proposal was submitted by the Additional



Transport Commissioner (February 2001) for revision of Composite-tax payable to the State of Nagaland on the basis of reciprocity but no revision has been made till date.

### **Monitoring controls**

Monitoring controls are designed and operated in a manner to ensure that the activities of the Department are being carried out as per the plan and any deviations are immediately identified and corrective action taken.

#### **5.1.20 Lack of co-ordination**

Every Department should maintain their books of accounts in such a way so that the actual position could be ascertained at a glance.

Cross verification of records of NST with those of MVT revealed that MVT had shown vehicle taxes outstanding against 23 NST vehicles whereas the records of NST exhibit another 31 nos of vehicles. Interestingly, it is to be mentioned that vehicle numbers enlisted in their respective statements differ from each other in respect of 23 (NST) and 31 (MVT) vehicles. This shows lack of co-ordination between two wings of the same Department which indicates improper monitoring of the Department.

#### **5.1.21 Internal Audit**

Internal audit, as an independent entity within or outside the Department, is to examine and evaluate the level of compliance with 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 Director of Treasuries and Accounts (Audit wing) under the Finance Department of the Government is entrusted with conducting internal audit of all Government Departments since its creation.

However, it was noticed that no audit manual was published by the Directorate of Treasuries till date and audit of the accounts of only two units (District Transport Office) out of eight units had been conducted during the period covered by the review. The Director of Treasuries and Accounts stated (August 2006) that though audit plan was prepared, targets could not be achieved due to shortage of manpower.

#### **5.1.22 Lack of response to audit**

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 2006, 312 Paragraphs involving Rs.14.11 crore relating to 66 IRs of the three wings of Transport Department issued upto April 2006 were still pending. Of these, 196 paragraphs (63 *per cent*) relating to 35 IRs (53 *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.

#### **5.1.23 Conclusion**

The internal controls in the Department were weak and ineffective. These need to be improved substantially to be able to fulfill the desired objectives of the Department. The internal controls needs to be designed, operated and monitored in a suitable manner so as to ensure that it becomes a tool for effective functioning of the Department.

#### **5.1.24 Recommendations**

The following recommendations are made:

- Expenditure needs to be regularly monitored to avoid excess/savings from the budgeted figures.
- Bill Registers and Stock registers should be maintained and verified as per rules.
- A system of physical verification of stores and stock need to be introduced and followed regularly.
- Internal audit wing should be established and a comprehensive audit manual prepared within the Department and audit coverage under the Department should be planned in such a way that all the 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 Report of the Accountant General (Audit) to ensure timely response to the observations made.