Chapter VIII: Internal Control

8.1 Internal Audit

The importance of robust internal control mechanism for a manufacturing Organization like Ordnance Factories cannot be overemphasized. Government rules and regulations do provide for internal control mechanisms like internal audit, vigilance, control by Ministry and superior authorities. As would be evident, it was seen that many such internal control mechanisms were allowed to collapse and become dysfunctional.

The Chief Internal Auditor of the Factories in a response to a query by audit on the functioning of the internal audit mechanism admitted that the internal audit teams could not raise objections against Ordnance factory organizations, as they functioned under their administrative and functional control of the executive. He stated in November 2009 that during 2006-07 to 2008-09, the internal audit mechanism failed to uncover any financial irregularities both at factory level and at the level of OFB.

The malaise was however deeper and structural. Between 2006-07 and 2008-09, the Internal Audit was under the control of OFB. The Chief Internal Auditor (Factories) was under direct functional and administrative control of the Member (Finance) of OFB. He functioned with the help of five Regional Internal Audit Officers (RIAO) who were primarily responsible for functions relating to finance and accounts and only additionally, Internal Audit. The Material Planning Sheet[23] was required to be approved by the Local Audit Officer (LAO), who was also the accounts officer in the factory. The RIAO were under functional and administrative control of the respective GMs/Sr. GMs of the Ordnance Factories. Such an arrangement violated the fundamental principles of independence of internal audit. The internal audit wing did not develop any manual, checklists or guidelines for conduct of such audit and functioned in an ad hoc manner.

[23] Material Planning Sheet is required to be generated by every factory to initiate procurement action. It shows the requirement, existing stock and dues in from previous supply orders if any to arrive at the net requirement for which procurement action is to be initiated.

The dysfunctional state of internal audit was reflected in the fact that as of March 2010, a total of 2137 audit objections were still outstanding. At the OFB level, there is a Networking Committee chaired by one DDG to monitor the internal audit objections. Only two meetings of the Committee were held in two years. As of November 2009, the last meeting was held in March 2008. At the Factory level, even though there was an ad-hoc Committee in each factory under the Chairmanship of Sr GM/GM and these committees were required to meet quarterly, such meetings were infrequent. In the past 15 quarters from quarter ending December 2005 to June 2009 in 39 Factories, 585 such meetings should have been held. Only 120 meetings were held. 80 *per cent* of the meetings required to be held were never held. In some of the Factories, from 2005-06 to date, only one or two meetings had taken place.

Analysis of the range of internal audit observations indicated that the focus was less on procurement and management of stores. In 18 Factories, only 9 *per cent* observations related to procurement.

8.2 Internal Vigilance

As in the case of internal audit, the state of internal vigilance was also poor. The vigilance set up in Ordnance Factories organization is headed by the Chief Vigilance Officer (CVO) at the Corporate Headquarters. He is assisted by two Directors. In addition, there were two Group Vigilance Officers (GVOs) at Kolkata and Avadi.

The foundation of the internal vigilance activities is on the vigilance officers at the factory level. These vigilance officers were required to undertake surprise vigilance inspection, implement preventive vigilance measures and also aid and advise the General Managers of the factory in vigilance matters. However, there was no dedicated vigilance officer in the Factories and they were invariably entrusted with a number of activities, including purchase and recruitment. The deployment of Vigilance Officers of the same organization on production, purchase, maintenance, day-to-day administration etc had direct conflict of interest with the vigilance responsibilities. The OFB and the CVO OFB failed in executive control of implementing the subject CVC directive.

CVC’s guidelines, among other things, envisage that the CVO should not be from the same organization and he should not hold the charge relating to recruitment and purchase. However, at all levels - from Ministry down to the Factories, such conflict of interest was noticed. In the Ministry, Joint Secretary (OF) who was responsible for processing cases of procurement within the domain of Ministry's powers also acted as the Chief Vigilance Officer for the Ordnance Factories.

The dysfunctional state of vigilance was reflected in the fact that 15 Factories submitted "Nil" reports on 18 vigilance sub topics continuously for the past three years. Even these "Nil" reports were usually delayed by six to nine months indicating lack of attention to the reports by the CVO and the OFB. Three Factories did not even submit these reports.

8.3 Delegation of Financial Powers from Ministry to OFB without any control mechanism in place

Ministry of Defence in December 2006 issued orders significantly enhancing the financial powers of the Ordnance Factory Board. The objective of such enhancement of powers was to enhance autonomy and increase the efficiency of the Ordnance Factories in its day-to-day functioning. The salient features of enhanced delegation as approved by the Ministry were

(1) All proposals concerning a particular factory should be finalized at the factory level wherein representative of OFB may be a member of PNC /CNC[24] for high value cases.

(2) Clubbing the proposals for input materials, required by more than one factory for realization of the benefit of bulk purchases leveraging quantity discount.

(3) In case of procurement where the price increase has been more than 8 *per cent* of LPR, then the matter should be put up to OFB for information along with justification; and

(4) Procurement from Rosoboronexport would not be treated as single vender case.

Following this, OFB on 11 April 2007 enhanced financial powers of various functionaries in Ordnance Factories for procurement of stores, plant and machineries. Such delegation increased financial powers of factory officials by as much as 9900 *per cent* in some cases. For procurement of stores through open tender or limited tender which is the main source of procurement of stores in the Factories,

[24] Price Negotiations Committee/ Cost Negotiations Committee

the power of GM was enhanced by 1900 *per cent* from Rs one crore to Rs 20 crore, that of Joint GM by 400 *per cent*. Even the powers of floor level Works Manager were increased by 525 *per cent*. For procurement of Plants and machinery through limited tender or open tender in replacement of BER[25] Plants and machinery, against projects sanctioned by government or to improve production under NC[26], the powers of General Managers were enhanced by 9900 *per cent* from Rs 10-25 lakh to Rs 20 crore.

However justified was such excessive delegation on a wide scale, it was carried out without any attention to the weak control environment and without any effort to improve the same. Ministry while delegating powers did not make any effort to put in practice enhanced control measures. With a collapsing internal audit, ineffective vigilance mechanisms and virtually no control by the Ministry, the control environment became even weaker with such vast powers at the field level.

An examination in audit of the nature and extent of delegation of financial power by OFB to Ordnance Factories indicated that the same was not in accordance with the letter and spirit of the order on the subject issued under MOD letter dated 20 December 2006. The Ministry for example stipulated that in cases of bigger purchases the PNC/CNC should consist of a representative of Ordnance Factories Board. However, OFB order dated 6 March 2007 delegating powers up to Rs 20 crore for purchase of stores and up to Rs 25 crore for Plant & Machinery to various functionaries in Ordnance Factories envisaged reconstituted Tender Purchase Committee (TPCs) which did not include any representative from Ordnance Factory Board. Ministry did not take any action to ensure that its intent was implemented.

Procurement through TPCs in the Factories represented a structural problem of decision making in the Factories. TPCs performed the functions of the CFA[27]. While such TPCs were headed by the CFA, the procurement cases were not considered separately on files based on the recommendations of the TPCs and no separate sanction order was issued for these procurements. While it

[25] Beyond Economic Repair
[26] New Capital
[27] Competent Financial Authority

promoted collegiate decision making, the accountability of the individual CFA could not be established in this process.

Ministry of Defence while delegating the financial powers also specifically advised on the price reasonableness and where ever the increase in prices was more than 8 *per cent* of the Last Purchase Price, the cases were required to be sent to OFB for information with justification. Based on Ministry's letter dated 20.12.2006, the OFB vide their letter 10/6/MM/(P&C) dated 24.4.2007 to all the GMs directed that all efforts are to be made to keep the prices in control and increase if any should be within 8 *per cent* of LPR. It was seen in audit that such cases were not reported by the General Managers nor were they checked by the OFB members. For cases finalized with more than 8 *per cent* price increase, reports along with justification duly linking with market indices, base metal price increases etc were to be submitted to concerned Member / operating division, with a copy to OFB / MM (P&C) division on monthly basis by fifth of the following month. At least 14 Factories did not furnish the reports since May 2007. OFB also did not monitor the reports.

8.4 Role of the TPCs

Rule 137 of the General Financial Rules requires every authority delegated with financial powers of procuring goods in public interest to own responsibility and accountability to bring efficiency, economy, transparency in matters relating to public procurement and for fair and equitable treatment of suppliers and promotion of competition in public procurement.

Rule 22 of the GFRs further states that no authority may incur any expenditure unless the same has been sanctioned by the competent authority. GFRs also envisage issue of sanction orders and lay down procedures for communicating such orders to accounting and auditing authorities.

OFB has laid down several layers of Tender Purchase Committees both at the headquarters and factory levels. Such purchase committees are invariably headed by the authority who otherwise would be the competent financial authority in that specific procurement case. Altogether 4 levels of TPCs are laid in OFB Headquarters and another four levels are laid at the factory level.

Paragraph 6.22 of the MMPM provides that TPC recommendations/decisions will provide necessary authority for placing orders after the minutes of the TPC proceedings clearly bringing out its recommendations/ decisions are signed by all the members.

While it encourages collegiate decisions, in all Factories, the TPC minutes were treated as the final approval of the procurement decisions. No separate sanction orders conveying the sanction of the Competent Financial Authority were issued. This diluted accountability of the CFA.