

Chapter - V

Internal Control

5.1 Internal audit and physical verification

Internal audit is an important constituent of the overall system of internal control²⁸ and is defined as a systematic and independent examination of data, statement, records, operations and performances of an organization. It is a managerial control for measuring and evaluating systems, procedures and operations within the organisation. Internal audit seeks to detect irregularities, mistakes and frauds through its concurrent or post-audit checking of accounting and other records and of actual operations at site. At the same time, internal audit constantly reviews the entity's internal controls, policies, plans and procedures with a view to providing assistance to the management to achieve economical, efficient and effective operations of the organisation.

The functions of internal audit in FCI, *inter alia*, broadly include examination and evaluation of compliance of the Corporation to prescribed rules and regulations, systems and procedures. Internal audit also conducts independent physical verification of the stock of food grains held in depots and reports variation in the accounting records. Weak internal audit would expose FCI to the risk of non-compliance with rules, systems and procedures, inefficiencies and lack of control on operations. Weakness in conduct of physical verification of stock would render FCI to the risk of fraud and misappropriation of food grain stock.

Audit examined the adequacy of internal audit arrangements and the physical verification conducted by Internal Audit and Physical Verification (IAPV) Division of FCI. The audit findings are discussed in subsequent paragraphs.

5.2 Organisational setup of internal audit and physical verification

The coordination of internal audit functions on an all-India basis is under the overall supervision of Executive Director (ED) who reports directly to the Chairman & Managing

²⁸ Internal control is defined as the plan of organisation and all the methods and procedures adopted by the management of an entity to assist in achieving management's objective of ensuring, as far as practicable, the orderly and efficient conduct of its business, including adherence to management policies, the safeguarding of assets, prevention and detection of fraud and error, the accuracy and completeness of the accounting records, and the timely preparation of reliable financial information.

Director, FCI. The ED is assisted by a General Manager with supporting staff. The internal audit work is coordinated at zonal level by a General Manager in the zones. The audit of regions is under the immediate charges of Deputy General Managers, who are assisted by a group of IAPV parties, each consisting normally of two Managers (Accounts).

5.3 Status of internal audit and physical verification

5.3.1 Shortfall in achievement of audit plan

An analysis of audit coverage revealed that on an average 519 depots were selected per year for internal audit during the period 2006-07 to 2011-12. Given the 1600 depots/ 169 district offices (including one port office) in FCI, all the units can be covered within a cycle of three years. The actual coverage, however, remained at an average of 386 depots and showed a decreasing trend during the period 2009-12. The number of internal audits planned and actual audit coverage by FCI during the period 2006-07 to 2011-12 was as under:

Table 5.1
Number of internal audits planned and actual coverage

Zones	2006-07		2007-08		2008-09		2009-10		2010-11		2011-12	
	P	A	P	A	P	A	P	A	P	A	P	A
North Zone	297	269	271	251	272	254	244	212	177	192	224	156
East Zone	47	18	101	15	56	1	87	3	87	10	41	5
North East Zone	20	12	18	3	28	7	29	6	31	11	56	38
South Zone	93	84	90	87	95	76	89	67	105	69	69	51
West Zone	83	81	82	77	80	75	79	69	82	68	78	46
Grand total	540	464	562	433	531	413	528	357	482	350	468	296

(P- Planned, A- Actual)

While audit coverage was in the range of 70 per cent to 108 per cent in the North Zone, in the East Zone, the coverage was only to the extent of 2 per cent to 38 per cent. This was followed by the North East Zone which recorded 17 per cent to 68 per cent. In West and South Zones, the audit coverage ranged from 59 per cent to 98 per cent and 66 per cent to 97 per cent respectively.

In respect of physical verification (PV) by internal audit, the number of PV planned and actual coverage during the period 2006-07 to 2011-12 was as under:

Table 5.2
Number of physical verifications planned and actual coverage

Zones	2006-07		2007-08		2008-09		2009-10		2010-11		2011-12	
	P	A	P	A	P	A	P	A	P	A	P	A
North Zone	294	266	269	250	269	251	243	211	177	190	224	145
East Zone	47	16	101	15	56	0	87	7	87	10	46	25
North East Zone	20	12	18	3	28	7	29	6	31	11	56	37
South Zone	93	84	90	87	95	76	89	67	105	69	69	50
West Zone	83	81	83	78	79	73	79	70	83	68	60	50
Grand total	537	459	561	433	527	407	527	361	483	348	455	307

(P- Planned, A- Actual)

As can be seen from the above table, the coverage for physical verification showed wide variation amongst different zones. While in North Zone, PV was done to the extent of 65 per cent to 107 per cent, it was done only upto 54 per cent in East Zone and 17 per cent to 66 per cent in North East Zone. In South Zone, the coverage remained in the range of 66 per cent to 97 per cent and in West Zone, it was between 82 per cent and 98 per cent.

Thus, on the whole, the actual audit coverage for PV as against the plan was between 67 per cent and 85 per cent during the period 2006-07 to 2011-12.

The Management stated (July 2012) that decrease in the coverage was due to depletion of manpower in the Audit Division, which stood at around 29 per cent of the sanctioned strength and the problem was being solved by recruiting new officers/ officials.

The Ministry stated (January 2013) that the Corporation has started recruiting Managers and Group III employees in accounts cadre, some of whom would be placed in Audit division.

5.3.2 Outstanding internal audit paragraphs

Audit observed that 8467 Internal audit (IA) paragraphs having a value of ₹ 2,395.68 crore were pending settlement as on 31 March 2012. The pendency of IA paragraphs was high in North Zone with minimum pendency in North East Zone. Outstanding paragraphs of IA and money value during the period 2006-07 to 2011-12 were as under:

Table 5.3
Outstanding paragraphs of Internal Audit with money value

Zones	2006-07		2007-08		2008-09		2009-10		2010-11		2011-12	
	TP*	Value (₹ in crore)	TP*	Value (₹ in crore)	TP*	Value (₹ in crore)	TP*	Value (₹ in crore)	TP*	Value (₹ in crore)	TP*	Value (₹ in crore)
North	5941	2,568.89	4435	2,567.12	3863	2,106.70	4275	2,138.99	4665	2,178.10	4449	2,022.90
East	4647	620.23	3313	390.74	2496	287.88	2261	285.57	2337	282.79	1932	285.32
North East	2244	214.31	471	90.55	248	20.64	117	9.94	140	23.25	194	21.39
South	1130	69.87	772	33.12	419	725.54	477	703.60	337	19.05	470	20.98
West	1165	57.13	663	67.73	606	35.40	710	46.26	584	35.99	834	45.09
Hqrs	972	0	952	0	1004	0	1026	0	1039	0	588	0
Grand total	16099	3,530.43	10606	3,149.26	8636	3,176.16	8866	3,184.36	9102	2,539.18	8467	2,395.68

*TP – Total Paragraphs

5.3.3 Outstanding paragraphs on PV under IA

Audit observed that 1447 outstanding paragraphs of physical verification conducted by internal audit were pending settlement at the end of 2011-12. The highest pendency of paragraphs was in the East Zone followed by North Zone. The outstanding PV paragraphs for the period 2006-07 to 2011-12 were as under:

Table 5.4
Pendency of physical verification paragraphs

(No. of paragraphs)

Zones	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12
North Zone	736	286	329	328	378	408
East Zone	1982	1395	959	881	876	806
North East Zone	617	20	15	4	10	49
South Zone	245	107	93	112	80	107
West Zone	323	60	61	55	58	77
Grand total	3903	1868	1457	1380	1402	1447

The Management stated (December 2011) that efforts were being made for settlement of physical verification paragraphs by forming audit committees.

5.3.4 Inadequacy in conduct of internal audit and physical verification

To examine the adequacy of internal audit arrangements and physical verification conducted by FCI during the period under review, Audit analysed the records of regional offices covered for detailed examination. Audit observations on the inadequacies of internal audit and physical verification actually conducted during the period of review are highlighted below:

- In Assam Region, out of nine districts covering 27 depots, 11 depots were not selected for Physical Verification for two to three years. Due to weak internal control, suspected misappropriation of rice/wheat stock amounting to ₹ 3.87 crore was noticed in seven districts²⁹ during the period under audit. In district offices of Guwahati and Tihu, PV of the stock was done by the custodian himself, which was in violation of the concept of “Custodian should not be verifier of stock” and the name and designation of the physical verification officer (PVO) signing the report was not properly recorded which lacks authenticity. As against 890 godown inspections planned during the period 2006-07 to 2011-12, 98 inspections were not conducted.
- In Bihar Region, except physical verification and internal audit conducted in Phulwarisharif depot, district office Patna during July/August 2009, no internal audit and physical verification of stock was done during the period 2006-07 to 2010-11 in other depots of entire Bihar Region by the IA&PV. Out of total 14 cases involving shortage of 26,069 MT food grains worth ₹ 52.90 crore in Bihar region, seven cases³⁰ were in the depots under district office Patna. The identity of PVO could not be ascertained from the PV reports of 2009 in district office Muzzafarpur. Even after detection of huge shortage by special PV teams, the coverage of internal audit and PV of stock did not improve much as these were done only in two district offices (Patna and Motihari) and in eight depots respectively during 2011-12.
- In West Bengal Region, out of 32 depots, internal audit wing did not conduct any physical verification during the period 2006-07 to 2010-11 except in four depots in the year 2009-10. Further, out of the total 20 district offices, 11 district offices were not audited for more than four years. The identity of PVO could not be ascertained from the annual physical verification report of district office Burdwan for the year 2011. As against 788 godown inspections planned, 101 inspections were not conducted. In 2011-12, except improvement in godown inspection (151 inspections out of 157 planned) and PV done in 16 depots, internal audit coverage continued to remain low as only one district office was audited.

²⁹ DO Kokrajhar, DO Bongaigaon, DO Jorhat, DO Dibrugarh, DO Banderdeva, DO North Lakhimpur, DO Silchar, DO Tejpur.

³⁰ Mokama, Phulwarisharif, Dumraon, Bihiya, Chausa, Buxar and Biharsharif.

- In Punjab Region, out of 629 depots planned for internal audit, 141 depots were not audited during the period 2006-07 to 2010-11. Further, out of a total of 593 physical inspections due for depots, 141 inspections were not carried out during the years 2006-07 to 2010-11. Further, a total of 74 cases of shortages were detected, out of which 64 cases were investigated and the shortage was written off accordingly. As against 3110 godown inspections planned during January 2006 to December 2010, inspections were not conducted in 125 cases. During the year 2011-12, 143 depot inspections were planned. Out of these, only 54 depot inspections were carried out leaving a balance of 89 depots.

In Chhattisgarh Region, out of 139 internal audits (118 depots and 21 district offices) planned, 13 internal audits (10 depots and 3 district offices) were not conducted during the period 2006-07 to 2011-12. Further, as against physical verification of 118 depots planned during the period 2006-07 to 2011-12, the same was not conducted in 10 depots.

- In Andhra Pradesh Region, out of 352 district offices/ depots planned for conducting internal audit, 58 district offices/ depots were not audited during the period 2006-07 to 2011-12. Further, as against 207 depots for which physical verification was planned during the six year period, the same was not conducted in 50 depots.
- In Haryana Region, as against 2583 godown inspections planned, inspections were conducted in 2578 cases during 2006-07 to 2011-12.

The Ministry stated (January 2013) that due to paucity in manpower, physical verification and godown inspections could not be conducted as planned.

5.4 Shortage of manpower in Internal Audit and Physical Verification division

The sanctioned strength of manpower of Internal Audit and Physical Verification division of FCI increased from 398 in 2006-07 to 447 in 2011-12. The men-in-position as against the sanctioned strength, however, remained in the range of 131 to 215 during the same period. The manpower position as against the sanctioned strength during the period 2006-07 to 2011-12 can be seen in table 5.5.

Table 5.5
Manpower position as against sanctioned strength

Year	Sanctioned strength	Men-in-position	Deficit	Deficit (in percentage)
2006-07	398	148	250	63
2007-08	519	215	304	59
2008-09	493	163	330	67
2009-10	493	144	349	71
2010-11	451	131	320	71
2011-12	447	141	306	68

Audit observed from the above that there was substantial shortage of manpower in the IA&PV division of FCI ranging between 250 and 349 during the period 2006-07 to 2011-12. The shortfall ranged between 59 *per cent* and 71 *per cent* of the sanctioned strength during the six year period.

It is evident that the functioning of internal audit and physical verification was largely inadequate. There was persistent shortfall in audit coverage and follow-up action on large number of internal audit and physical verification reports were outstanding. A number of deficiencies were noticed in conduct of PV of stocks. Substantial shortfall in manpower in internal audit wing had adversely affected the internal audit system in FCI. While FCI headquarters prepared audit plan for the whole zone/region, the actual implementation and follow-up action thereon was carried out at the regional and zonal levels without direct monitoring and supervision from the FCI headquarters. Thus, the internal audit activities at the zonal level lacked the requisite independence.

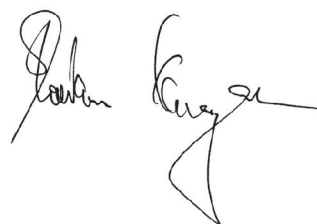
The Management stated (December 2011/July 2012) that paragraphs raised and settled were reviewed on a monthly basis region-wise. Apart from that, gist of important paragraphs was submitted by region on monthly basis to FCI headquarters. Monitoring of observations made in IA&PV reports was done at zonal level. Direct monitoring of PV being undertaken at remote depots, by the headquarters was neither feasible nor desirable, as FCI had offices at Zonal, Regional and District level. Instructions for conducting PV by staff other than the custodian of the stock already existed and were broadly being followed.

The Ministry has confirmed (January 2013) that shortfall in manpower had affected both the audit and physical verification coverage as well as the follow up action on the Audit and PV reports. To maintain independence of Audit, audit officers in internal Audit Division report directly to Head of Internal Audit Division in the Region/Zone. Internal Audit function was being monitored and supervised by the ED (IA) from the headquarters for execution of Annual Audit Plan. Review meetings/audit activities were being monitored by Audit Division of headquarters.

Audit, however, observed that the role of FCI headquarters was limited to preparation of tentative annual audit plan and its execution and follow up action on points raised were being done at Zonal level. There was no direct involvement of officials from FCI headquarters. In the absence of independent heads of Internal Audit Divisions in the region/zones who would actually report directly to ED (IA) at FCI headquarters, independence of audit as stated by Ministry would remain unfulfilled. Thus, internal audit and physical verification arrangements followed by FCI lacked the required independence and effective follow up mechanism at the headquarters level.

Audit recommendations and responses of the Ministry

Sl. No.	Recommendations of Audit	Ministry's replies
10	FCI should review the internal control arrangement with a view to strengthen manpower and to increase internal audit activities and coverage of physical verification of stock.	Accepted.
11	FCI should consider strengthening supervision and control of FCI headquarters over internal audit and physical verification activities to ensure independence.	Accepted.



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Countersigned



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