

CHAPTER – VII
INTERNAL CONTROL AND INTERNAL AUDIT

**PUBLIC HEALTH ENGINEERING AND WATER SUPPLY
DEPARTMENT**

7.1 Internal control mechanism and internal audit

7.1.1 Introduction

Internal Control is an integral process which is designed to provide reasonable assurance for achieving objectives *viz.*, fulfilling accountability obligations, complying with applicable laws and regulations, executing orderly, ethical, economical, efficient and effective operations and safeguarding resources against loss. It is a dynamic integral process that is continuously adapting to the changes faced by an organisation. Management and personnel at all levels have to be involved in this process to provide reasonable assurance of achievement of the objectives.

Internal Audit, on the other hand, is an internal control mechanism that evaluates the efficiency and effectiveness of other types of internal controls. Internal Audit works as the ‘eyes and ears’ of higher management. Internal Audit is also an independent appraisal of the activities within the organisation for review of accounting, financial and other business practices and it works as a protective and constructive arm of the management.

The Public Health Engineering and Water Supply (PHE&WS) Department in the State started functioning from May 1995 and has taken over all water supply schemes for both urban and rural areas from the Public Works and Rural Works Departments and was responsible for rural and urban water supply including maintenance in compliance with the laws and regulations in force.

7.1.2 Organisational set-up

The Commissioner and Secretary, Public Health Engineering and Water Supply (PHE&WS) is the administrative head of the Department. The Chief Engineer, PHE&WS department is responsible for planning, execution, monitoring and evaluation of water supply projects and is assisted by four Superintending Engineers in Headquarters and three circles and 16 Executives Engineers in the divisions.

The department in exercise of internal control at different levels through executives, follow the Central Public Works Department Codes and Manuals. Financial control is exercised through submission of monthly accounts and expenditure statements.

For effective administrative control and proper financial management in the State, the Government of Arunachal Pradesh created (June 1999) an independent Directorate viz., the Director of Audit and Pension to deal *inter alia* with audit matters (both internal and statutory).

7.1.3 Audit coverage

Records of the Chief Engineer, PHE&WS, Superintending Engineer, Itanagar Circle (out of three circles), four selected PHE&WS divisions (out of 16), Finance Department and Director of Audit and Pension covering the period from 2002-03 to 2004-05 were test checked in May 2005. Points noticed during test check are discussed in the succeeding paragraphs.

Internal control systems

7.1.4 Planning

The annual plan of the State Government is the main operational instrument for Five Year Plans. On the basis of available financial resources the departments are to ensure fund provision for spill over schemes. The work programme for completion of water supply schemes as formulated by the department and provision of funds made thereagainst during 2002-03 to 2004-05 were as under:

Table 7.1

Year	Opening balance of incomplete schemes (Numbers)	Number of new schemes sanctioned	Total number of schemes	Provision made during the year	Amount required for completion of ongoing schemes	Percentage of provision to actual requirement	Numbers of schemes completed
				(Rupees in crore)			
2002-03	530	287	817	13.14	53.91	24	383
2003-04	434	296	730	13.90	46.32	30	387
2004-05	343	489	832	15.82	66.89	24	NA

It would be seen from the table that the percentage of funds provided ranged between 24 and 30 *per cent* of the actual annual requirement. Taking up new schemes every year without providing adequate funds for completion of ongoing schemes only delayed the completion of the schemes besides requiring more funds on their completion due to time overrun. This is indicative of improper planning in the department.

7.1.5 Budgetary Control

The State Government did not have any budget manual of their own and the provisions of the General Financial Rules are followed for formulation of budget and other financial matters. The non-Plan budget proposals were to be prepared by the Controlling Officer i.e. Chief Engineer on compilation of the

inputs obtained from all the drawing and disbursing officers (DDOs) for its onward submission to the Finance Department through the Administrative Department in a consolidated form. In case of Plan budget, the annual plan outlay is finalised in consultation with the State Planning Department. For effective control as well as for estimation of savings in or excess over grants, returns of expenditure were to be obtained from the DDOs. The spending departments are required to surrender the grants/appropriations or portion thereof to the Finance Department as and when savings are anticipated.

Year-wise budget provision made, expenditure incurred and savings during the period from 2000-01 to 2004-05 are shown below :

Table 7.2

(Rupees in crore)

Year	Budget Provision	Expenditure	Excess (+) Savings (-)
2000-01	65.89	61.58	(-) 4.31
2001-02	66.95	65.60	(-) 1.35
2002-03	70.87	63.59	(-) 7.28
2003-04	83.59	77.43	(-) 6.16
2004-05	138.78	130.42	(-) 8.36
Total	426.08	398.62	(-) 27.46

Source : Appropriation Accounts

Although there were recurring savings during 2000-01 to 2004-05, the Department had not surrendered the savings except during 2001-02.

Scrutiny revealed that the Chief Engineer had received budget proposals from the DDOs under his control but had not compiled the same for scrutiny and preparation of consolidated budget proposal of the department. The returns of monthly expenditure as received from the DDOs although compiled had not been examined by the Chief Engineer from time to time to ascertain probable excess or anticipated savings. This had led to non surrender of savings by the department and the Finance Department was not able to reallocate the amount of savings to other needy departments.

Rules provide that controlling officers should maintain a liability register, obtain liability statements monthly from the DDOs and provision for anticipated liabilities should invariably be made in the Demands for Grants.

Test check of records of the Chief Engineer, PHE&WS revealed that the liability register had not been maintained by obtaining the liability statements from the executing divisions. Scrutiny however, revealed that there were outstanding liabilities of Rs.1.58 crore as of March 2005 in Itanagar division (Rs.0.63 crore) and Yupia division (Rs.0.95crore).

The above points are indicative of defective and unrealistic budgeting as well as ineffective control.

7.1.6 Expenditure control

The Chief Engineer exercised control over expenditure by issue of monthly Letter of Credit against requirement of the executing divisions. Under the existing system, the Chief Engineer is required to compile the monthly expenditure statements received from the executing divisions and submit monthly consolidated expenditure statements to the Finance Department. These statements were, however, submitted by the Chief Engineer without exercising any check over the expenditure incurred by the divisions as would be evident from the following deficiencies:

Rules provide that no work should commence or liability thereon be incurred until administrative approval, expenditure sanction, technical sanction and appropriation of fund is obtained from the competent authority. Test check of records of the Executive Engineer, PHE&WS division, Ziro revealed that the division had incurred an expenditure of Rs.2.37 crore against Letter of Credit received from Chief Engineer for implementation of “Augmentation of Water Supply Scheme at Hapoli” without observing the requisite formalities.

Issue of Letter of Credit by Chief Engineer for the work not yet sanctioned was irregular and the purpose of issue of Letter of Credit for controlling expenditure was defeated.

Para 2.30 and 2.31 of CPWD Manual Vol-II state that when the expenditure on a work is likely to exceed the sanctioned estimate by 5 *per cent* in case of works costing more than Rs.5.00 lakh and by 10 *per cent* in case of works costing upto Rs.5.00 lakh, a revised expenditure sanction is required to be obtained from the competent authority before incurring further expenditure.

Test check of records revealed that in three PHE&WS divisions (Itanagar, Seppa and Ziro), the Divisional Officers incurred expenditure of Rs.9.44 crore on nine works against the sanctioned amount of Rs.5.32 crore at an average of 77 *per cent* above the sanctioned estimates as detailed in **Appendix – XLIV** without obtaining revised expenditure sanction from the competent authority.

Expenditure incurred without provision

The PHE & WSD did not maintain any stores and stock. The procurement of materials are being done directly charging to the works executed. As such procurement of materials for works should always be in consonance with the provisions of sanctioned estimates and Chief Engineer/Superintending Engineer, being controlling officers, should always oversee the activities of the executing divisions.

During March 1998 the Superintending Engineer, Naharlagun Circle made an agreement with a local firm for supply of 300 mm dia 1960 Rm MS Pipes for utilisation in the work “Improvement of water supply scheme at Seppa – Phase I” under the Executive Engineer PHE&WS division, Seppa. The Executive Engineer received 1960.25 Rm MS pipes of 300 mm dia between November and December 1998 for which an amount of Rs.45.87 lakh was paid to the firm in March 1999.

Test check of records revealed that the sanctioned estimate did not provide for utilisation of 300 mm dia MS pipes and as such the materials were still lying unutilised with the division (May 2005).

Test check of records of three divisions (Itanagar, Ziro and Seppa) further revealed that between December 2002 and April 2005 the divisions incurred expenditure of Rs.13.28[#] lakh towards repairs, maintenance and purchase of petrol *etc.*, for the vehicles attached to the divisions and charged the entire expenditure on different water supply works though there were no provisions in the sanctioned estimates. The above facts indicated lack of control in the department to meet the accountability obligations as well as compliance with rules and regulations.

Issue of supply order/work order in excess of permissible financial limit

The financial limit for award of work of a Divisional Officer without call of tender was Rs.15 lakh per annum.

Test check of records of four divisional offices (Itanagar, Yupia, Ziro and Seppa) revealed that during 2004-05, the Executive Engineers issued 1302 supply order/work orders valued Rs.7.57 crore in excess of the permissible financial limit as detailed below:

Table 7.2

Sl No.	Name of the Division	Number of supply/work orders issued	Value (Rupees in crore)
1	EE PHE & WS Division, Itanagar	453	2.51
2	EE PHE & WS Division, Yupia	112	0.73
3	EE PHE & WS Division, Ziro	442	3.20
4	EE PHE & WS Division, Seppa	295	1.13
Total:		1302	7.57

This indicated laxity in the control system.

7.1.7 Inspection of works

It is incumbent upon various executives concerned with various works to inspect the works frequently to ensure that the works are being executed according to design, drawing and specifications laid down in the contract. The Inspecting Officers (SE, EE, AE and JE) should ensure issue of instructions by way of recording their findings in the inspection register at site or by issue of inspection notes, a copy of which is required to be pasted in the inspection register. None of the four divisions (Itanagar, Yupia, Ziro and Seppa) test checked maintained any Inspections Register nor could any inspection note be made available to Audit.

[#] Itanagar: Rs.7.44 lakh; Ziro: Rs.5.44 lakh and Seppa: Rs.0.40 lakh.

The Divisional Officers of the divisions test checked stated (May 2005) that spot verification of works were conducted by them and necessary instructions given to the AE/JE. Replies of the Divisional Officers were, however, silent about inspection, if any, conducted by other officers. It is not known as to how the specified Running Account bills were passed for payment without having stage-wise inspection reports of SE as required.

7.1.8 Management Information System

With increasing requirement of information for planning, monitoring and implementation of various schemes and on line monitoring of all Rural Water Supply Schemes in the State it was felt necessary to introduce computerised Management Information System in the department. Accordingly, a memorandum of understanding was signed (July 2004) with NIC and NICS for development of web based MIS software modules.

It was however, noticed that the system has not been introduced throughout the department as yet. In reply to an audit observation, the Chief Engineer, PHE&WSD stated (May 2005) that the computerisation programme is in progress.

7.1.9 Internal Audit System

Internal Audit is an important management tool of a department to examine and evaluate the level of compliance to departmental rules and procedures.

Test check revealed that during last five years none of the PHE&WS division was audited by the internal audit wing of the Director of Audit and Pension. The Joint Director of Audit and Pension stated (August 2005) in response to an audit query that audit of PHE&WS divisions could not be taken up since inception (May 1995) of PHE&WS Department due to shortage of staff in Internal audit wing. The reply is not tenable as men-in position in internal audit wing were the same as the sanctioned strength.

The matter was reported to the Government (July 2005), reply had not been received (October 2005).

7.1.10 Conclusion

Internal Control System in the department was deficient and led to poor planning and defective and unrealistic budgeting. Release of funds by Chief Engineer, PH&WSD through Letter of Credit for works not even administratively approved, incurring of expenditure in works beyond sanctioned provision and issue of supply/work orders by the Divisional officers in excess of permissible financial limits indicated lack of control over expenditure in the department. Inspection required to be conducted at each level of the functionaries had also not been done. Management Information System required for planning and monitoring has not yet been introduced throughout the department. Besides, Internal audit of the department was not done since its inception by the Internal Audit Wing under the Finance Department.

7.1.11 Recommendations

- To achieve the desired objectives internal control system needs to be strengthened at all levels in the department;
- Budget proposals should be realistic;
- Planning of works programme should be improved for timely completion of the projects through proper funding;
- Expenditure should be incurred only on approved projects;
- Management Information System should be introduced throughout the department for proper planning and monitoring;
- Internal audit system in the state also needs to be strengthened to ensure functioning of internal control system in the departments effectively for achieving the desired objectives; and
- Government may consider for establishment of an Internal Audit Cell in the departments.

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