CHAPTER – V

INDUSTRIES AND COMMERCE DEPARTMENT

5.1 Internal control system in Industries and Commerce Department

Internal control is an integrated process by which an organisation conducts its activities so as to obtain reasonable assurance that its objectives are achieved in an economical, effective and efficient manner. It comprises methods and policies designed to protect resources against loss due to waste, abuse and mismanagement. Evaluation of the internal control system in the Industries and Commerce Department disclosed that budgetary, administrative, accounting, operational and monitoring controls were not effective to ensure compliance with established procedures/practices. This was further compounded by absence of internal audit during the period covered by audit. Non-maintenance of basic records also affected the accuracy and completeness of accounts.

Highlights

Budget estimates were not prepared on the basis of actual requirement which resulted in overall savings of Rs.54.68 crore during 2002-07.

(Paragraph 5.1.7)

An amount of Rs.5.31 lakh was unauthorisedly and fraudulently drawn by the District Industrial Centre, Wokha.

(Paragraph 5.1.13)

Recovery of loans from beneficiaries were not monitored properly. During 2002-07 only Rs.2 crore (4 *per cent*) had been recovered out of Rs.50.84 crore due for recovery.

(Paragraph 5.1.16)

Subsidy receiving industrial units were not verified periodically resulting in payment of Rs.57.67 lakh to closed units.

(Paragraph 5.1.18)

The Department failed to monitor the execution of various schemes.

(Paragraph 5.1.21)

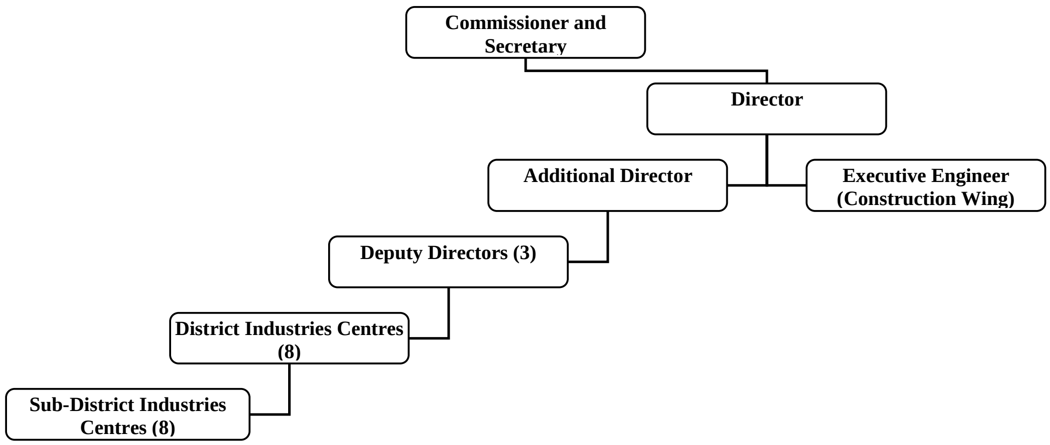
5.1.1 Introduction

Internal control is a mechanism to govern the activities of an organisation to effectively achieve its objectives. A built-in internal control system and strict adherence to statutes, codes and manuals provide reasonable assurance to the organisation about compliance with applicable norms and rules, reliability of financial reporting and effectiveness and efficiency in operations.

The main objectives of the Industries and Commerce Department are promotion of industries, facilitate creation of infrastructure required for development of industries and payment of assistance by way of loans, grants and subsidies to industries in both public and private sectors.

5.1.2 Organisational set-up

The Commissioner and Secretary is the administrative head of the Department. The organisational set up of the Department is given below:



5.1.3 Audit objectives

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

- budgetary and financial controls
- administrative controls
- operational controls, and
- monitoring controls

5.1.4 Audit criteria

Audit findings were benchmarked against the following criteria:

- Industrial Policy Act, 2000
- Internal control system prescribed by the Department
- Central Treasury Rules
- General Financial Rules

5.1.5 Scope of Audit

Review of the internal control system including internal audit arrangements in the Department for the period 2002-07 was conducted during July 2007, by a test check of the records in the office of the Director of Industries and Commerce, three District Industries Centres (DICs) in Dimapur, Wokha and Mokokchung and the office of the

Director of Treasuries and Accounts. The results of the test check are brought out in the succeeding paragraphs.

5.1.6 Audit methodology

The review was conducted through a test check of the records in the Department and audit conclusions were arrived at on the basis of analysis of data, information and replies provided by the office of the Director of Industries and Commerce/DICs. An exit conference was held (03 August 2007) with the Director and other officers of the Department wherein audit findings were discussed and their replies have been incorporated in the review at appropriate places.

Audit findings

5.1.7 Budgetary and financial controls

The actual expenditure *vis-à-vis* budget provision of the Department during 2002-07 was as follows:

Table 5.1

(***Rupees in crore***)

Year	Budget Provision			Expenditure			Excess (+) Savings (-)			Percentage of excess/savings	
	Plan	Non-Plan	Total	Plan	Non-Plan	Total	Plan	Non-Plan	Total	Plan	Non-Plan
2002-03	39.53	9.92	49.45	25.04	7.51	32.55	(-) 14.49	(-) 2.41	(-) 16.90	37	24
2003-04	53.16	3.57	56.73	32.99	7.96	40.95	(-) 20.17	(+) 4.39	(-) 15.78	38	123
2004-05	30.56	13.29	43.85	17.79	13.28	31.07	(-) 12.77	(-) 0.01	(-) 12.78	42	---
2005-06	51.34	4.92	56.26	45.15	4.92	50.07	(-) 6.19	-	(-) 6.19	12	---
2006-07	45.85	7.96	53.81	42.64	8.14	50.78	(-) 3.21	(+) 0.18	(-) 3.03	7	2
Total	**220.44**	**39.66**	**260.10**	**163.61**	**41.81**	**205.42**	**(-) 56.83**	**(+) 2.15**	**(-) 54.68**		

Source: Appropriation Accounts

Against a budget provision of Rs.260.10 crore (Plan and Non Plan) during 2002-07, the savings under Plan heads ranged between 7 to 42 *per cent* and the excess under Non Plan heads ranged between 2 to 123 *per cent*. Excess under Non Plan heads indicated faulty budget preparation and savings under Plan heads indicated the Department's failure to effectively and efficiently implement its mandate for development of industries in the State. Variance in non Plan provision was not available on record.

5.1.8 Failure to surrender anticipatory savings in time

Timely surrender of savings is a key budget control measure so that funds can be appropriately used by other departments. As per General Financial Rules, all anticipated savings are to be surrendered to the Government by 10 March of the financial year. Though the Department had savings every year during 2002-07, funds were not surrendered on time. As a result these savings could not be utilised by other departments where there was excess expenditure over Budget provision. Thus, the financial discipline sought to be imposed through General Financial Rules was ignored by the controlling officer of the department.

5.1.9 Irregular drawal of money to avoid lapse of funds

The Central Treasury Rules (CTR) restrict the drawal of money from the treasury unless it is required for immediate disbursement. It was observed that during 2003-04 to 2005-06, the Director of Industries and Commerce drew Rs.2.89 crore[46] and credited it to 'Civil Deposit' to avoid lapse of funds for periods ranging from 6 to 18 months, thus, defeating the purpose for which funds were sanctioned. It further resulted in exhibition of inflated expenditure figures for the Department during these years. This irregular practice resulted in erosion of accountability and legislative control over expenditure, as the drawals from civil deposits in subsequent years neither require 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 violated the basic principles of legislative control over State finances.

Test check of records further revealed that the Director had been retaining huge cash balances at the close of every year for the last five years as shown below:

Table-5.2

Month/Year	Closing balance as on 31 March
March 2003	3,60,57,720
March 2004	18,61,43,966
March 2005	7,05,91,188
March 2006	12,82,59,292
March 2007	12,02,17,005

Source: Departmental records

As seen from the cash book, this balance arose due to release of funds by the State Government at the fag end of the year. Although the Department withdrew the amount against different financial obligations, it could not make payments immediately and retained the amount in cash/civil deposit/bank accounts in violation of Financial Rules.

5.1.10 Rush of expenditure

Rush of expenditure at the fag end of the financial year indicates lack of proper expenditure control and risk of the Government not getting proper value for money as it indicates rush of expenditure to avoid lapse of funds. General Financial Rules require 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. It was seen that the Department had incurred 11 *per cent;* 13 *per cent;* 30 *per cent;* 34 *per cent* and 21 *per cent* of its

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Bill No and Date	Amount	Date of deposit
401 dated 17-3-2004	1,02,43,909	Chalan No.6 dated 31-3-04
464 dated 30-3-2005	37,70,673	Challan No.21 dated 31-3-05
510 dated 31-3-2005	38,00,000	By transfer credit on 31.03.2005
Bill No.312 dated 5-12-05	1,00,00,000	By transfer credit on 05.12.2005
Bill No 275 dated 18-11-05	10,50,000	challan No. 20 dated 31-3-05
Total	**2,88,64,582**	

total expenditure in March during 2003 to 2007 respectively as detailed below. This together with the unspent balances at the end of the years (as detailed in Paragraph 5.1.9) would add up to 22 *per cent*, 58 *per cent*, 53 *per cent*, 61 *per cent* and 43 *per cent* of its total expenditure during 2002-03 to 2006-07 respectively.

Table-5.3

(Rupees in crore)

Year	Total expenditure during the year	Expenditure in March	Percentage of expenditure in March to total expenditure
2002-03	32.36	3.58	11.06
2003-04	41.44	5.25	12.67
2004-05	31.07	9.28	29.87
2005-06	48.41	16.50	34.08
2006-07	54.57	11.36	20.82

Source: departmental figure

It will be noticed from the above that 11 to 34 *per cent* of the expenditure was incurred in the month of March, which was against financial norms. Considering that a substantial portion of the Department spending is on account of loans and subsidies to industrial units, rush of expenditure in March will not facilitate due diligence in sanctioning the loans/subsidies.

The Department accepted (August 2007) the facts during exit conference.

Administrative controls

5.1.11 Quality of maintenance of records

Test check of records of the Director of Industries and Commerce revealed that expenditure control records like allotment register and compilation register of monthly expenditure of the entire Department, prepared on the basis of monthly expenditure statements received from lower formations, were not maintained properly. During the period under review, no expenditure control measures like physical verification/surprise check of cash balance by the Head of the Office and cash analysis at the end of each month as required under rules, was carried out in any of the offices test checked. In the absence of accurate and complete expenditure control records the transactions of the Department could not be vouchsafed in audit.

This indicated lack of administrative control in the Department.

5.1.12 Bill Register and Bill Transit Register

As per Receipt and Payment Rules, expenditure control records like Bill Register and Bill Transit Register are to be maintained by all Heads of offices who are authorised to draw money on bills signed by them. The registers should be reviewed monthly and bi-monthly respectively by a competent authority and the result of the reviews should be recorded therein to prevent presentation of fraudulent bills for payment. Scrutiny of records revealed that though these expenditure control registers had been maintained, these had never been reviewed by any competent authority as prescribed under rules. Thus, the expenditure lacked monitoring and review and the chances of overdrawal, excess and fraudulent drawal cannot be ruled out.

5.1.13 Fraudulent drawal

Test check of records in the office of the General Manager, District Industrial Centre (DIC), Wokha, revealed that an amount of Rs.5.31 lakh was drawn from the treasury in 52 bills during August 2003 to December 2006 but was not recorded in the cash book of the office. Out of 52 bills, the details of only seven bills (Rs.75,893) were recorded in the Bill Register. Actual Payee Receipts in support of the payment of Rs.5.31 lakh was also not produced to audit. Thus, on account of absence of monitoring, review and expenditure control measures, the possibility of Rs.5.31 lakh being fraudulently drawn and embezzled cannot be ruled out.

The Department accepted (August 2007) the facts during exit conference.

5.1.14 Outstanding Medical advances

As per Medical Attendance Rules, advance drawn for medical treatment should be adjusted by a corresponding medical re-imbursement bill within three months from the date of drawal or immediately after completion of treatment, whichever is earlier. The rule further stipulates that the advances should be treated as final charge under the service head concerned and the primary responsibility for watching the recoveries will be that of the sanctioning authorities. The controlling officer should adjust such advances by submission of regular bills for amounts reimbursable by Government as far as possible, before the close of the financial year.

Test check of records revealed that medical advance of Rs.4.80 lakh remained unadjusted against twelve officials of the Department for periods ranging from 12 to 68 months. No action was taken to recover the advance from the delinquent officials.

The Department accepted (August 2007) the facts during exit conference.

5.1.15 Presumptive Fraud

The Director of Industries and Commerce had drawn an amount of Rs.17 crore during 2001-02 (Rs.4 crore in December 2001 and Rs.13 crore in March 2002) for payment to employees under Voluntary Retirement Scheme (VRS), consequent upon the winding up of the Nagaland Sugar Mills Corporation (NSMC) Ltd. Dimapur.

Scrutiny revealed that against the drawal of Rs.17 crore, an amount of Rs.15.24 crore was paid to 594 retired employees in two installments during December 2001 to June 2002. However, inspite of audit requisition (July 2007), payment records of the balance amount of Rs.1.76 crore such as proposal furnished to the Government, list of employees, actual payee receipts, calculation statements etc., were not produced to audit. In the absence of the above basic records, audit could not verify the veracity of the payment of Rs.1.76 crore. Thus, the possibility of the amount being fraudulently drawn and misappropriated cannot be ruled out.

The Department accepted (August 2007) the facts during exit conference.

Operational controls

Operational controls are enforced with regard to setting up of industrial estates, identifying industrial potential of various areas, implementation of programmes, trainings and revival of sick units etc. Deficiencies in operational controls are summarised below:

5.1.16 Deficiencies in system of loans and recoveries

For promoting handloom and cottage industries, small and medium scale industries and self employed persons, loan amounting to Rs.3.63 lakh was paid to four[47] industrial units during 2002-03 and 2004-05. Test check of records pertaining to margin money loan revealed, that the Department did not take any action to ensure that the amount was utilised for the purpose for which it was sanctioned. Expenditure control records like loan recovery registers were not up-dated, outstanding balances at the end of each year were not communicated to the loanees and notices on due dates were also not issued. Further, reconciliation of loan remittances with treasury figures was not conducted and the Department did not also pursue recovery of loans. Only random notices were issued to defaulters.

Out of a loan of Rs.68.90 lakh given under Project Package Scheme during the period from 1997-98 to 2004-05, only Rs.30 lakh (43.54 *per cent*) was recovered, leaving a balance of Rs.38.90 lakh (56.46 *per cent*) due for recovery. Further, an amount of Rs.50.15 crore was paid to 5000 unemployed youth under Prime Minister's Rozgar Yojana during 2001-02 to 2005-06, out of which, only an amount of Rs.1.70 crore (3.39 *per cent*) was recovered, leaving a balance of Rs.48.45 crore (96.61 *per cent*) due for recovery. This indicates the lackadaisical attitude of the Department and absence of accountability and expenditure control. The lack of serious intent on the part of the Department would adversely affect the promotion of industry and entrepreneurship in the State. Failure to recover also indicated that selection of beneficiaries was not reliable and transparent. The possibility of fraud and embezzlement cannot be ruled out.

The Department accepted (August 2007) the facts during exit conference.

5.1.17 Non verification of industrial units granted subsidy

According to the conditions of sanction of subsidies, industries availing subsidy should operate their units at least for five years. The DICs were to carry out annual inspection and take action to recover subsidy wherever the units had ceased to function before completion of the specified period of five years. Scrutiny of records revealed that none of the 1305 small scale industrial units that availed of subsidy of Rs.68.14 crore during 2002-07, was verified during the last five years. Timely action was not taken to ensure submission of utilisation certificates by the societies/industrial units/NGOs.

Thus, the Department did not follow up on the subsidies sanctioned to ensure that the purpose for which subsidy was paid was achieved and the amount recovered in case

[47] (1) M/s Sunrise Steel Fabrication, (2) M/s K. Angami Steel Company, (3) M/s Diamond Fabrication and (4) M/s Sema Steel Fabrication.

of non-functioning of the unit. The Department restricted its role only to distribution of subsidy whereas its larger role was to promote industrial growth and entrepreneurship in the State.

5.1.18 Inadmissible payment of transport subsidy to closed units

According to All India Census of Small Scale Industries conducted during November 2002 to April 2003, altogether 608 industrial units in Nagaland were reported non-functional/closed. Scrutiny of records revealed that eight non-functional industrial units were paid transport subsidy of Rs.57.67 lakh in 2004-05 and 2006-07. Further, manpower subsidy of Rs.2 lakh was also paid to one closed unit.

The Department accepted (August 2007) the facts during exit conference.

5.1.19 Unfruitful expenditure

The Nagaland Mechanised Bricks Corporation Ltd., Dimapur was commissioned (August 2004) at a cost of Rs.9.91 crore. The objective of the corporation was to produce one lakh bricks per day and to earn a revenue of Rs.42.84 crore per year. The target for production was abruptly reduced in the same month (August 2004) to 35,000 bricks per day but even the reduced target could not be achieved. As a result, production of bricks was suspended (September 2005) and the Corporation was closed due to heavy losses. During the years 2005-06 and 2006-07, an amount of Rs.1.03 crore was incurred on staff salaries and establishment charges of the corporation without bonafide activities. Against the revenue of Rs.2.68 crore that should have been earned @ Rs.1.80 per brick for 35,000 bricks (reduced target) during the period from August 2004 to September 2005, the Department could earn only Rs.78 lakh resulting in shortfall of revenue collection by Rs.1.90 crore. Thus, lack of proper planning in setting up the Corporation resulted in its closure and loss of anticipated revenue to the corporation.

The Department accepted (August 2007) the facts during exit conference.

5.1.20 Loss of Government revenue

An Industrial Growth Centre with 74 units was constructed at a cost of Rs.17.90 crore and commissioned (January 2006) with the objective of providing a compact area for promoters to set up industries. Scrutiny revealed that none of the units had been allotted (July 2007) and the project remained idle for a period of 18 months resulting in avoidable idling of assets and loss of the targeted rent to the tune of Rs.57.92 lakh. Further the purpose for which the Growth Centre was created was defeated.

The Department accepted (August 2007) the facts during exit conference.

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.

5.1.21 Lack of supervision/monitoring of schemes

The Department implements various Centrally Sponsored and State Sponsored Schemes such as Project Package Scheme, Health Package Scheme, Pradhan Mantri Rozgar Yojana, Medicinal and Aromatic Plants, Handloom Development Schemes, Deen Dayal Hathkargha Protsahan Yojana and Incentives under State Industrial Policy 2000 etc. However, during the period under review, the Department had not monitored or evaluated the performance of the projects under these schemes so as to take appropriate measures for their successful implementation.

5.1.22 Internal Audit

Internal audit, as an independent entity within the Department, is responsible for examining and evaluating the level of the Department's 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 Department did not have any Internal Audit wing. Director of Treasuries and Accounts (Audit wing) under Finance Department of the Government was entrusted with internal audit of all Government Departments. However, it was noticed that no internal audit of Industries and Commerce Department had been conducted during the period under review. The Director, Treasuries and Accounts stated that internal audit could not be conducted due to shortage of manpower.

5.1.23 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 respond within a specified period. A half yearly report on the pending IRs is also sent to each department to facilitate monitoring of compliance with audit observations.

As of March 2007, 306 paragraphs involving an amount of Rs.124.97 crore relating to 44 IRs of the Industries and Commerce Department issued upto March 2007 were still pending. Of these, 180 paragraphs (59 *per cent*) relating to 25 IRs (57 *per cent*) were more than 10 years old. Failure to address the issues raised by Audit facilitated the continuation of serious financial irregularities and loss to the Government.

5.1.24 Conclusion

Internal controls were non-existent in the Department. Budget was not prepared on a realistic basis and basic checks such as proper maintenance of cash book, timely submission of reports and returns, loan recovery system and monitoring of the projects were disregarded. Failure to observe internal control procedures has increased the risk of misappropriation and fraud going unnoticed. There was no evidence of action against the erring officials or units that defaulted in payments. The Department failed to submit progress reports/utilisation certificates in time.

5.1.25 Recommendations

The following recommendations are made:

- Budget should be prepared on a realistic basis with inputs from lower formations and savings should be surrendered on a timely basis.
- Expenditure needs to be regularly monitored and rush of expenditure should be avoided at the fag end of the year.
- System of monitoring the loans and subsidies to units needs to be reviewed in the light of mounting dues and defaults and appropriate action should be taken.
- Payment Register of Subsidy/Loan and Recovery Register should be maintained and kept updated.
- 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 streamline the system of response to audit observations and ensure that the issues raised in the Inspection Reports are promptly addressed.