

CHAPTER- V

INTERNAL CONTROL SYSTEMS AND INTERNAL AUDIT ARRANGEMENTS IN GOVERNMENT DEPARTMENTS

INTERNAL CONTROL SYSTEMS AND INTERNAL AUDIT ARRANGEMENTS IN PUBLIC WORKS DEPARTMENT

5.1 Introduction

Internal Control and Internal Audit Systems safeguard against errors and irregularities in operational and financial matters. These systems examine and evaluate the level of compliance with departmental rules and procedures and assure senior management on the adequacy of risk management and internal control framework in the department. The Public Works Department (PWD) of the Government of Uttaranchal is mainly responsible for construction of National/State/District/Rural roads, bridges and buildings as well as their maintenance. Budgetary, administrative, operational, expenditure and financial management aspects of the Internal Control System of the PWD have been examined in this review.

5.2 Organizational set-up

The PWD is headed by a Secretary at Government level. Chief Engineer (CE)-level-I is the head of the department assisted by two CEs-level-II and 12 Superintending Engineers (SEs) responsible for implementation of the projects/schemes. Executive Engineers (EEs) are incharge at the divisional level and are assisted by Assistant Engineers at the sub-divisional level.

5.3 Audit Coverage

Records of 7* out of 54 divisions of the PWD for the period 2002-2005 were test checked by Audit between July and September 2005 to evaluate the effectiveness of internal controls through examination of records and test check of transactions. This chapter also contains the findings emerging from audit of PWD Divisions (*Appendix-5.1*) conducted during the year 2004-05, Appropriation Accounts 2004-05 and scrutiny of monthly accounts submitted to the Accountant General's office in 2004-05.

* Construction Division- Narendranagar (Tehri Garhwal) and Ramnagar, Provincial Divisions- Bageshwar, Dehradun, Haridwar, Ranikhet and Rudrapur

5.4 Audit objectives

The audit objectives were to ascertain the adequacy and effectiveness of the internal controls such as budgetary, operational, financial, administrative and expenditure controls through examination of records.

5.5 Internal Audit

Internal Audit functions as an independent entity, within or outside the department, to examine and evaluate the level of compliance with the departmental rules and procedures so as to provide independent assurance to senior management on the adequacy of risk management and internal control framework in the department. The Government of Uttar Pradesh issued (November 1998) instructions for formation of Internal Audit Organizations (IAO) in all departments. During test check (July-September 2005) it was noticed that there was no IAO in the Department. CE level-1 in reply stated that no structure for Internal Audit had been approved for the department so far (October 2005). Failures were noticed at various control levels (budgetary, financial, operational, administrative and expenditure), as discussed in the subsequent paragraphs, which could have been avoided had there been a system of Internal Audit in the Department. Therefore, there is an urgent need to establish an Internal Audit Wing.

5.6 Budgetary Control

Financial Rules stipulate that the Chief Engineer will see that the grant of the year is fully expended and any money which is not likely to be needed during the year is promptly surrendered. The budget provision and expenditure of the Department for the years 2002-03 to 2004-05 is shown below:

Table no. 1

(Rs. in crore)

Year	Budget Provision	Expenditure	Excess (+)/ Saving (-)
2002-03 (Revenue Voted)	161.38	134.02	(-) 27.36
(Capital Voted)	278.11	142.32	(-) 135.79
2003-04 (Revenue Voted)	177.55	139.80	(-) 37.75
(Capital Voted)	176.11	169.91	(-) 6.20
2004-05 (Revenue Voted)	192.57	162.36	(-) 30.21
(Capital Voted)	308.30	284.86	(-) 23.44

Source: Departmental figures

Budget provision of Rs. 278.11 crore under Capital Voted (2002-03) came down to Rs. 176.11 crore (2003-04) and went up to Rs. 308.30 crore (2004-05). The above table also shows that there were persistent savings under revenue as well as capital heads. The department was neither able to assess the requirement of funds realistically or to adequately monitor the expenditure.

5.7 Operational control

5.7.1 Improper use of savings

As per financial rules it is an important function of the Divisional Officer to keep a constant watch over the progress of expenditure and *inter-alia* take early steps for surrendering probable savings. This was not done, as would be seen from the cases discussed below.

5.7.2 The agreement for construction of Ring Radial road from Niranjapur bend to Shimla bypass was made (March 2003) at Rs. 1.20 crore (17.22 per cent below the estimated cost of Rs. 1.45 crore). The benefit of this saving of Rs. 0.25 crore was not passed on to the public exchequer. Instead, extra items of a foreseeable nature, such as edge wall on right side of road were executed under the same agreement at a cost of Rs. 8.39 lakh out of the saving. The EE replied (July 2005) that extra items were executed as per need with the sanction of the competent authority. The reply is not tenable as extra items were of a foreseeable nature. If they were essential, they should have been included in the detailed estimates.

5.7.3 The work of reconstruction and improvement of Chaka – Pendaras motor road (km. 1 – 11.125) was administratively and technically sanctioned (August 2002) by the Tehri Hydro Development Corporation Ltd. (THDC) at a cost of Rs. 2.19 crore (including compensation) for execution by the Construction Division, Narendranagar, as a deposit work. Test check of records (June 2005) of the Division revealed that against the estimated cost of Rs. 1.68 crore for the construction work (excluding compensation) the expenditure was Rs. 1.36 crore, resulting in a saving of Rs. 0.32 crore as shown below:

Table no. 2

(Rs. in lakh)

Sl. No.	Name of work/ Reference of Contract Bond (CB)	Revised estimated amount	Actual exp. as per variation statement	Net saving against the estimated cost (Col 3-4)
1	2	3	4	5
1.	Reconstruction and improvement of Chaka – Pendaras motor road (km. 1 – 5) C.B. 1 SE/2003-04 dt. 22.4.03 Tender at 3.8 per cent below.	81.82	74.30	7.52
2.	Reconstruction and improvement of Chaka – Pendaras motor road (km. 5 – 11.125) C.B. 2 SE/2002-03 dt. 22.2.03 Tender at 9.5 per cent below.	85.75	61.53	24.22
Total		167.57	135.83	31.74

Source: Departmental figures

The division did not inform the THDC of the saving and obtained the full estimated amount of Rs. 2.19 crore. Scrutiny revealed that expenditure of Rs. 5.30 lakh was incurred on slip clearance and contingencies (which were not included in the estimates) out of the saving. The EE stated (June 2005) that the contractor was not responsible for removing the slips, which occurred after

completion of work. The fact remains that the saving was not intimated to the funding agency and was unauthorisedly used for contingent expenditure which was booked under the capital head.

5.7.4 Lack of provision for centage charges

As per government orders (1997) centage charges @ Rs. 12.50 *per cent* would be charged on works carried out for non-government organizations, local bodies and commercial departments.

Test check (June 2005) of records of Construction Division, Narendranagar revealed that provision for centage charges was not made in the detailed estimate (DE) for reconstruction and improvement of Chaka Pendaras motor road, referred to in paragraph 5.7.3 above. The division later raised a demand of Rs. 27.43 lakh for centage charges @ Rs. 12.50 *per cent* which was rejected (August 2004) by the THDC on the ground that the provision was not included in the DE made available to the THDC.

On this being pointed out, the EE replied that provision for centage charge had escaped inclusion but this was realisable as per Clause-2 of the Memorandum of Understanding (MoU) signed with THDC and efforts to get Rs. 27.43 lakh as centage charges were under way (November 2005). The reply is not tenable as the department itself prepared the detailed estimate without the inclusion of centage charges thereby diluting Clause-2 of the MoU.

5.7.5 Non-closing of stock account

A management information system is a critical component of an Internal Control System. Management decision-making can be adversely affected by unreliable or misleading information or lack of information. Paragraphs 223 to 229 of Financial Hand Book-Volume VI (FHB Vol VI) require half yearly closing of stock as well as tools and plants to be done in the divisions every year so that profits and losses on stock may be accounted for. Test check of records of the Provincial Division (PD), PWD, Dehradun revealed that stock return for the half year ending March 2004 was not closed. The subsequent stock return for the half year ending September 2004 was closed (December 2004) with a surplus balance of Rs. 17.10 lakh, against a book value of Rs. 4.09 lakh (valued at Rs. 21.19 lakh at current rate) under the orders of the EE, despite the opinion of the Divisional Accountant that it would be improper to close the account without closing the account of the previous half year.

Test check of records of the EE, PD, PWD Haridwar revealed that the stock included 527 empty bitumen drums and 66 empty barrels. Despite this, the division locally purchased 435 empty drums at a cost of Rs. 2.87 lakh which was unjustified. It was also noticed that the EE had neither done half yearly closing of stock after March 2004 nor appended Form 73 (Stock, Receipt, Issue and Balance) with the monthly accounts submitted to the Accountant General's office after September 2004. Profits and losses on stocks could not, therefore, be ascertained, thereby putting the issue rates of stock in an area of risk.

Test check of records of the EE, Construction Division, PWD Narendranagar, revealed a deficit in stock of Rs. 0.32 lakh (half yearly closing March 2005), which has not been adjusted. According to financial rules, the deficit in stock should be adjusted by debit either to the work for which the stores were specially collected or to losses on stock.

5.7.6 Non fixation of Reserve Stock Limit

As per provisions of the State PWD Manual, a Reserve Stock Limit (RSL) has to be fixed for every division by CE to exercise control over overstocking. It was, however, observed (July-September 2005) that no RSL was fixed by the CE for the seven divisions test checked.

5.8 Administrative /Financial Control

5.8.1 Outstanding Miscellaneous Work Advances

As per financial rules (Paragraph 578 and 584 of FHB Vol. VI) transactions relating to (i) sales on credit (ii) expenditure incurred on deposit work in excess of deposits received (iii) losses, retrenchments, errors etc. and (iv) other items are booked under the head Miscellaneous Works Advances and are cleared either by actual recoveries or by transfer under proper sanction of competent authority, to the appropriate heads of account. The divisional officer and the controlling officer are responsible for prompt clearance of these items. Test check of five divisions* (July to September 2005) revealed that Rs. 2.04 crore were outstanding for one to twenty eight years against departments, Government employees and firms and contractors. The concerned divisions did not take effective action for adjustment or recovery. There is a risk of the dues becoming irrecoverable, thereby causing loss to the Government.

5.8.2 Outstanding hire charges of plants and machinery

The PWD system provides for the cost of maintenance of machinery and equipment being met from their hire charges. These charges are paid by the user civil divisions as per the demands raised by the Mechanical Divisions on the basis of actual running hours of the machines. Hire charges of Rs. 0.45 crore remained payable by 14 civil divisions to the mechanical divisions as of December 2005 as per records in the office of the SE (Mechanical).

5.9 Expenditure control

5.9.1 As per financial rules, tenders should invariably be invited in the most open and public manner possible and in the case of large contracts, time for submission of tender should be at least one month. Financial rules further provide that technical sanctions, which guarantee that the proposals are structurally sound and the estimates are accurately calculated and based on adequate data, must be obtained before a work is commenced.

* Construction Division- Ramnagar, Provincial Divisions- Bageshwar, Dehradun, Ranikhet and Rudrapur

Test check (August 2005) of records of the Executive Engineer (EE), Construction Division, PWD, Ramnagar revealed that contrary to the provision of financial rules for wide publicity, short term tenders (with 10 days time) on two bid system for three works viz, Haldwani-Ramnagar motor road, Kesowala- Bannakheda-Belparao motor road and Jagnathpur motor road, were invited as a package without obtaining the technical sanction of the competent authority. As per records, three tenders were received. The tender of M/s R.G. Buildwell was shown as pre-qualified and the sole eligible tenderer and accepted (Rs.14.03 crore) at 1.03 *per cent* below the estimated cost of Rs. 14.17 crore. Reason for disqualifying the other two bidders could not be ascertained as no documents were furnished to Audit. The agreement was made between the Superintendent Engineer and the contractor on 23 February 2004 with the same date as the date of commencement of work, whereas the technical sanction of the Chief Engineer (Kumaon region) was accorded on 19 March 2004. Comparative study of rates in the technical sanction as given in the detailed estimated (DE) and rates allowed in the contract bond (CB) revealed that higher rates on various items (Haldwani-Ramnagar motor road) had been allowed to the contractor. An undue benefit of Rs. 2.96 lakh, as worked out in the table given below, accrued to the contractor:

Table no. 4

Name of Items	Per unit rate as per sanctioned DE (Rs.)	Per unit rate as per CB (Rs.)	Difference per unit (Rs.)	Quantity as per Running Bill	Impact (Rs. in lakh) Col. (4x5)
(1)	(2)	(3)	(4)	(5)	(6)
1. Bituminous macadam 80-100 mm thick (cum)	2417	2434	17	12522.28	2.13
2. Bituminous macadam 50 mm thick. (cum)	2605	2609	4	9201.05	0.37
3. Semi dense bituminous concrete 25 mm thick (cum)	3362	3366	4	4471.46	0.18
4. Supplying & fixing pre-cast tiles. (cum)	454	470	16	1914.44	0.31
Rs. 2.99 lakh-1.03 per cent below = Rs. 2.96 lakh					2.99

Source: Departmental figures

Note: The work was in progress and the amounts in column No. 6 would increase on completion of the work.

On this being pointed out in audit, the EE replied (August 2005) that the work was taken up in anticipation of technical sanction. It was also stated that no irregular benefit was given to the contractor as the cost of tender was below the cost technically sanctioned. The reply is not acceptable as (i) short term tenders were invited, (ii) the contract was signed before the technical sanction (iii) and at rates higher than those given in the technical sanction. The contractor was benefited despite the total cost of the contract being lower than the estimated cost. Moreover, the total value of work done (upto August 2005) against the contract of Rs. 14.03 crore was Rs. 15.01 crore (Rs. 13.37 crore against original work + Rs. 1.80 crore against extra items - Rs. 0.16 crore tender 1.03 *per cent* below).

5.9.2 Scrutiny of records (July 2005) of the Executive Engineer (EE), PD, PWD, Dehradun revealed that rates and quantities in schedule 'B' of the contract bond for construction of radial ring road from Niranjapur bend to Shimla bypass Saharanpur road were higher than the sanctioned detailed estimate. This inflated the estimated cost of Rs.1.23 crore by Rs. 0.22 crore (*Appendix-5.2*).

5.9.3 Absence of Reconciliation

It was the responsibility of the Department to reconcile monthly the expenditure figure with those booked by the Accountant General. Due to incomplete reconciliation, there were differences of Rs. 23.40 crore and Rs. 149.99 crore in Revenue Voted and Capital Voted section respectively under Grant 22 PWD during the period 2002-03 to 2004-05 (November 2005) as shown in *Appendix-5.3*. Thus, a key control for ensuring accuracy of accounts was disregarded.

5.10 Controls at Treasury level

Control activities should be an integral part of operations and should include a system of verification and reconciliation. An important control in the case of PWD divisions is the system of monthly settlement of accounts with all the treasuries in respect of the transactions of the entire division. Differences between the cash book and the bank statement are to be communicated to the treasuries for rectification. Test check revealed the following differences in Part-I and Part-II of Form 51 in the cash book of the divisions:

Table no. 5

(in Rupees)

Name of Divisions	Month	Part I	Part II
PD, PWD, Dehradun	April 2005	2214864.85	2565166.46
PD, PWD, Haridwar	September 2003	(-) 3913906.19	778290.16
PD, PWD, Ramnagar	April 2005	1035222.29	548677.00
PD, PWD, Rudrapur	June 2005	(-) 33034.00	1457488.00

Source: Departmental figures

Delay in reconciliation of accounts increases the risk of misappropriations remaining undetected.

It was seen that 15 division of the PWD failed to submit Form-51 during the year 2004-05 along with their monthly accounts submitted to the Accountant General (*Appendix-5.4*). In the case of PD, PWD, Haridwar the lacuna was persisting from October 2003. This reduced the reliability and completeness of the monthly accounts and compromised the integrity of the reporting system.

5.10.1 Delay in submission of monthly accounts

Timeliness is an important attribute of the information objectives of the internal control process. The Financial Hand Book prescribes that the monthly accounts be submitted by the EE to the Accountant General's Office between

the 7th and 10th of the month following the month to which it relates. Accounts for the month of March are required to be submitted by 15 April. It was noticed that 216 monthly accounts of PWD were submitted late during the year 2004-05 (**Appendix-5.5**).

5.11 Expenditure in excess of Deposits

Capital outlay on deposit works is required to be limited to the amounts of deposits received. During the scrutiny of record of three test checked divisions*, it was observed that expenditure of Rs. 61.01 lakh on deposit works in excess of deposit received was incurred.

5.12 Lack of response to Audit

Accountant General conducts periodic inspection of Government transactions and the audit findings are communicated through Inspection Reports to the Heads of Offices/Departments to comply with the audit observations and rectify the defects. Replies to these Inspection Reports are required to be furnished to the Accountant General within six weeks of the date of issue. However, as on April 2005, 105 Audit Inspection Reports (AIRs) of PWD for 2004-05 having 145 paragraphs involving a money value of Rs. 89.86 crore were pending settlement as mentioned below:

Sl. No.	No. of AIRs	No. of Paras	Nature of Para	Amount (Rs. in crore)	Nature of failure of internal control mechanism
1.	16	26	Losses	13.87	Administrative control
2.	14	18	Excess expenditure	10.23	Budgetary control
3.	14	1	Avoidable Expenditure	6.67	Expenditure control
4.	22	31	Irregular Expenditure	26.10	Administrative control
5.	20	26	Infructious & Unfruitful Expenditure	11.50	Execution of schemes
6.	19	28	Other Irregularities	21.49	

From the above it would be seen that several serious irregularities involving substantial money value have been commented upon in the Inspection Reports but have not been settled as yet. Failure to comply with the issues raised by audit facilitates the continuation of serious financial irregularities and wasteful expenditure or losses to the Government.

* (i) EE, PD, PWD, Narendranagar- Rs. 1.06 lakh (ii) EE, PD, PWD, Haridwar- Rs. 5.55 lakh (iii) EE, PD, PWD, Dehradun- Rs. 54.40 lakh

5.13 Conclusion

The Internal Control System viz. budgeting, administrative, operational, financial and expenditure control in the PWD was inadequate. Savings were not anticipated and surrendered as required and were used for unauthorized purposes. No Internal Audit Wing was set up as required, thereby depriving the Department of an independent assurance on the adequacy of the risk management and internal control frame work.

5.14 Recommendations

The PWD should consider appropriate measures, including the following, to activate the Internal Control System.

- Scrutiny and approval of budget estimates should be done carefully in order to ensure that allocation of funds is as per requirement and savings are monitored and surrendered in time.
- Financial rules regarding invitations of tenders should be adhered to.
- A proper technically sanctioned estimate should be made the basis for the contract bond. Increasing the rates and quantities in comparison to the sanctioned estimates should be avoided and viewed seriously as this amounts to undue/irregular benefit to contractors.

The matter was reported to the Government (December 2005); reply is awaited (February 2006).