सत्यमेव जयते

Policy Paper

On

New Functional Paradigm For

Internal Audit in DAD

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Ministry of Defence, Govt. of India

POLICY PAPER

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FOR
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Ulan Batar Road, Palam Delhi Cantt-110 010

May 2016

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FOREWORD

The concept of Internal Audit has globally witnessed a total transformation of approach from a mere compliance and propriety related focus to one based on performance outcomes and processes. In addition there is a move towards a Risk-Based Audit. This paradigm shift envisages that an internal control and risk management framework serves as an effective governance model. The need for reorientation of Internal Audit in the Defence Accounts Department was taken up with the objective to align with international best practices. A concept paper on "New Functional Paradigm on Internal Audit" was prepared and circulated to all the field offices inviting their views in the matter. The comments received were analyzed and formalized as a frame-work which incorporates the above concepts in the structure, methodology, protocols etc. in the internal audit mechanism of the Department and the products generated as a result of the audit.

As the mandate and role of internal audit continues to evolve, it should be our endeavour to provide an independent assurance to the executives on the effectiveness of the systems for managing risks and safeguarding the larger interest of the organization. I am happy to present the New Functional Paradigm on Internal Audit which will serve as a set of standards to assist the internal auditor in performing their role and duties.

(Shobhana Joshi)
Controller General of Defence Accounts

FOREWORD

Apart from Payment, Accounting functions & Financial advise functions executed by Defence Accounts Department for Defence Services, they are required to play a very important role to enforce Accountability and Transparency by way of performance of concurrent and constant Internal Audit of transactions, procedures and organisations, operational in the Defence system of the country. With the growing complexity of economies and constant evolution of new disciplines, it has become essential to delegate powers to various functionaries in the systems. Increase in range and depth of delegated powers has generated a large number of competent Financial Authorities (CFAs) and Internal Financial Advisors (IFA's) in the system. Growth in Defence Budget and growth in the number of CFAs and IFAs and massive increase in the number of decisions taken by them has made it absolutely essential to strength the system of Internal Audit in Defence System. Maximum utility of Internal Audit is not merely to CFAs and IFAs in the system but also to the executive authorities at the highest level in Ministry of Defence. Auditors give their independent feedback to MoD on the existing state of affairs in various organisations and also in what manner the decisions are being taken under the delegated powers by various CFAs and organisations. This involves massive effort which culminates in the Report about the state of Defence preparedness out of scarce public finances, mobilised by political system, from relatively under developed economy and society having a large number of persons living below the poverty line, for meeting the essential defence requirements. In this background, it becomes necessary and mandatory for auditors to generate "Value for Money" audit reports in all areas of defence expenditure.

This not only calls for tremendous expertise and adequate levels of manpower, it also calls for maximum cooperation from all Defence Services and various organisations working under their control. As timely availability of information is of great utility for auditors to finalise their Audit Reports, Government of India would be required to ensure free and timely flow of information to Internal Audit Systems.

2.   The 'New Functional Paradigm in Internal Audit' tries to meet this requirement. Reorientation of audit is a process and not a one-time activity and this process is required to be continued by incorporation in the Codes and Manuals.

3.   It is hoped that the outline of the new audit structure will serve as a guideline for the audit being done by Department.

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New Functional Paradigm for Internal Audit in DAD

1.   Need for new functional paradigm

1.1 The Defence Accounts Department conducts audit of Defence Services receipts and expenditure. The audit by the DAD is distinct from the audit carried out by the Director General of Audit (Defence Services), an organization of C&AG of India, which is in the nature of 'statutory' audit. The audit conducted by the DAD is in the nature of internal check on defence receipt and expenditure including check on the subsidiary accounts maintained by the Defence Services.

1.2 The audit mandate of the Defence Accounts Department essentially flows from the Financial Regulations for Defence Services and the charter of rendering an Audit Certificate by the CGDA annually as the Principal Accounts Officer of the Ministry of Defence, certifying the correctness of accounts. Based on this certification, Secy Def. Fin. /FA (DS) and Defence Secretary endorse the certificate on Annual Appropriation Accounts prepared by the Ministry as the Chief Accounting Authority. C&AG of India through its office of DGADS carries out test checks (statutory audit) on the Annual Appropriation Accounts prepared by the Ministry and certifies the accounts before its submission to the Parliament. DAD also finds a mention as internal auditee for Defence in the Defence Services Estimates.

1.3 As per standard international practices, every organization needs to have an 'Internal Control and Risk Management' framework which is a basic conceptual structure used to address the risks faced by an organization. The process of assessing, monitoring and responding to risks in order to reduce their impact is achieved through the implementation of a risk management framework which consists of risk identification; risk prioritization; risk mitigation; implementation of mitigation plans; and review and monitoring of mitigation plans.

1.4 Risks are associated with every activity and these can adversely affect the target achievements in terms of quantitative and qualitative parameters. In the MoD and Services Headquarters, a plethora of activities relate to provisioning and

procurement of a range of products to ensure serviceability levels of the weapon systems and platforms and operational capabilities, and that the modernization and maintenance plans are undertaken with the aim of maintaining and enhancing the country's defence capabilities. Since risks in these activities are inherent, there is a need to implement an appropriate and robust risk management framework. Further a large quantum of powers to undertake such activities have been delegated to lower formations. Therefore any effective system of decentralization needs to necessarily have an appropriate oversight mechanism as an integral element of the ecosystem based on the principle of "Reasonable Assurance" to the executive at the highest level, in this case Raksha Mantri. An effective way of doing it is through formulation of an 'Oversight and Internal Audit' mechanism or a Committee framework.

1.5 The term oversight means the general process of review, monitoring, evaluation, supervision, reporting and audit of the organization's programmes, activities, policy implementation and results. This is to ensure organizational, financial, operational and ethical accountability, effectiveness of internal controls and prevention of fraud and malpractices. The purposes of the oversight policy are to ensure good governance, create the necessary environment of accountability and transparency in the organization and ensure that the operations are effectively carried out through continuous improvement. The scope of the oversight policy is shaped by the following principles of good governance –

a. The activities of the organization are fully in accordance with its laid down mandates;

b. The funds provided to the organization are fully accounted for and in full compliance with project/programme targets/goals;

c. The activities of the organization are conducted in the most efficient and effective manner, and duplication and inefficient use of resources is avoided;

d.   The staff and all other officials of the organization adhere to the highest standards of professionalism, integrity and ethics.

1.6 For an objective and effective risk-management framework, most developed countries as well as modern business organisations follow the 'Three Lines of Defence' model, which is being adopted in India also as an internationally accepted best practice for risk management in an organisation. The three lines of defence model is used as the primary means to demonstrate and structure roles, responsibilities and accountabilities for decision making, risk and control to achieve effective governance, risk management and assurance. The first line of defence is the 'Line Management' of any organisation, which is not only responsible to carry out the regular activities but is also responsible for identifying risks and improvement actions, for implementing controls and for reporting progress. The second line of defence is the internal control mechanism/structure of the organisation which also includes designing policies, setting direction, introducing best practices, ensuring compliance and providing assurance oversight for the policy makers/top management. The third line of defence entails independent challenge, audit of key controls, formal reporting on assurance, and audit of assurance providers' and entity level controls assurance. This is achieved through the system of internal audit, whose role is to maintain oversight and to monitor the effectiveness of internal control and risk management processes, as well as the internal audit activities.

2. Existing Scope of audit by DAD

a). The primary function of audit by the DAD is to verify the accuracy and correctness of accounts to secure that

(i) All receipts are brought to account under the proper head
(ii) All expenditure and disbursements are authorized, vouched and correctly classified

(iii) The final account represents a complete and true statement of the financial transactions it purports to exhibit.

b). The audit responsibility as above is fulfilled by the DAD through following activities:

(i). Audit of Sanctions and Orders affecting financial transactions issued by authorities lower than Govt. of India of following categories

    aa. Rules and general orders

    bb. Grants and appropriations

    cc. Sanctions to expenditure

(ii). Audit of transactions arising out of the sanctions issued as above.

(iii). Audit of Stores Accounts of the Defence Services units and formations

(iv). Audit/Inspection of Cash Accounts of the Defence Services units and formations

3.   Existing Internal Audit setup and procedures: Some of the major organisations and their audit procedures are mentioned below:

3.1.1. Army: LAOs/RAOs under Regional PCDA/CDA are responsible for the audit of receipt and expenditure and transactions originating in the units/formations under their jurisdiction. Audit of works expenditure is carried out by RAOs. In exercising test check, LAO is given discretion to select samples of vouchers and transactions for audit. Audit coverage has been provided to every Army unit/Formation by LAO offices which are covered under peace Accounting System.

3.1.2. Army Ordnance Corps (AOC): In case of Ordnance Depots, a Computerized Inventory Control Programme (CICP) exists for ordnance store inventory, Phase-I has been completed & IInd Phase is under progress. Data base of programme is accessible to those LAO officers, who are attached with the major Ordnance Store Depots.

3.1.3. PBOR: Pay Accounts of the PBORs are computerised in PAOs. There is only review of the old printed IRLAs by the review group but the master record is not audited with the Sheet Roll. It is only at the time of retirement that the pay is audited, since his recruitment and pending credits and debits are acted upon causing inconvenience to the PBOR.

3.2. Air Force: The Accounts maintained by all AF units/ formations are subject to audit by a co-located LAO. Audit is generally based on a test check of some transaction. A hundred percent audit check is not feasible under present system with existing manpower and LAOs have discretion to select sample for test check.

 AUDOLS   (Audit On Line System) software is developed by the Department by outsourcing to carry out Internal Audit in Logistic Section of Air Force Unit consequent on introduction of IMMOLS (Integrated Material Management On Line System) in Air Force. AUDOLS has been developed by Tata Consultancy Services in C++. AUDOLS is integrated software interlinked with IMMOLS. Information is extracted from IMMOLS through server installed at station Logistics section under LAN. Implementation of AUDOLS has been organized in three stages Viz. Initial audit; Audit supervised parallel run and e-audit. Certain units are visited by the LAO periodically/ half yearly as directed by the CDA (AF).

3.3. Navy: Audit is in form of detailed transaction and voucher linking audit, checking of authorization. The department is also responsible for audit of cash accounts kept by OC ship/naval dockyard. Integrated Logistics Management System (ILMS) related to inventory of Naval stores. Integrated Clothing Management System (ICMS) which is on Navy Enterprise Wide Network (NEWN), Ship Material Management System (SMMS) and their respective Audit Module are under test & trial. Internal Audit of Naval Units is carried out primarily by PCDA (N) through a network of 9 NLAOs (Naval Local Audit Office) including the AO (Navy) Chennai and AO (Navy) Kolkata.

3.4. Ordnance Factories: A Chief Internal Auditor is responsible for audit of OFB, and Ordnance Factories. CIA (OFs) is independent of Accounting and Factory

management and reports directly to the CGDA. Audit is carried out by 16 sub-offices co-located with Factories/Group of Factories. Audit Functions include audit of Expenditure, Receipts, Service Books, Cash inspection, inventory management, pay etc. CIA Kolkata started Risk Based Internal Audit in 2009 and also has instructions in place for Information System audit. It also uses audit software IDEA which is being used by C&AG and RBI. The objections are consolidated issue wise before sending to the CGDA/MoD. Ordnance Factories have computerised database available for procurements, stores, pay and costing. The Annual Accounts of OFB is not audited before placing before the Board and CIA is not a member of the Board. Though the Quarterly Internal Audit Reports are placed before the Board, they are not taken into cognisance. Audit Committees at Board level are not functional. At Factory level meetings chaired by GM/SGM are attended by SAO/AAO as there are no IDAS an officer posted in Zonal offices.

3.5. CSD: The Objectives of audit carried out by the CDA (CSD) (for CSD HQ) and Local Audit Offices (for Depots) under him to ensure that the financial and other resources placed at the disposal of the CSD are used properly and to ensure that the commercial accounts of the CSD are prepared correctly and are complete in all respects and are submitted on due dates. CSD has computerized some of its operations.

4.   Types of Audit at present and methodology

a)   **Compliance audit**: This type of audit examines the transactions relating to expenditure, receipts, assets and liabilities of Government for compliance with the rules and regulations. Orders and instructions issued by the Competent Authority either in pursuance of the laws or by virtue of the powers formally delegated to it by a superior authority. It includes:

(i). **Audit against provision of funds:** To ascertain whether the expenditure was incurred for authorised purpose.

(ii). **Audit against rules and regulation**: To see that the expenditure incurred was in conformity with Audit against rules and orders would involve interpretation of

the rules / orders. Auditors' duty stops with bringing to the notice of the competent authority any action that is, in their opinion, contrary to the rules /orders on the subject. It is for the authority which is vested with the power to make rules to take a view in the matter and decide on the further course of action.

(iii). **Audit of Sanctions** To see that every item of expenditure was done with the approval of the competent authority in the Government for expending the public money.

(iv). **Propriety Audit:** which extends beyond scrutinising the mere formality of expenditure to its wisdom and economy and to bring to light cases of improper expenditure or waste of public money. It is an essential and inherent function of Audit to bring to light not only clear and obvious irregularities but also every matter which, in the judgment of auditors, appears to involve improper expenditure or waste of public money or stores even though the accounts themselves may be in order and no obvious irregularity has been committed.

b)   **Performance audit:** Performance Audit is also called Efficiency-cum-Performance Audit (ECPA) or Value for Money (VFM) audit. It is a comprehensive review of the projects, programmes, schemes, organisations, etc. in terms of their goals and objectives aimed at ascertaining the extent to which the expected results have been achieved from the use of available resources of money, men and materials. Performance audit is an independent assessment or examination of the extent to which an organization, programme or scheme operates economically, efficiently and effectively. The reports are most of the time, filed without any action.

5.   Imminent and long term challenges being faced by the department

a)   With increase in the   Defence   Budget, the   number of transactions to be handled by the DAD has gone up significantly.

b)   The manpower available with the Department has been continuously depleting. This has resulted in under deployment of manpower for internal audit work

c)   There has been wide scale delegation of powers to Defence Services. This has resulted in increase in number of sanctions issued by units and formations lower than MoD and consequent   increase in   work of audit.

d)   There is lack of response by auditee units. Effective action is not taken for rectifying the deficiencies. Irregularities pointed out by the Internal Audit persist and are repeated. Though there is mechanism for the disposal of internal audit reports, there is no enforcement mechanism in case of non-compliance. There is no time-bound mechanism for enforcing accountability. There is no practice of follow-up tests to ensure implementing corrective action.

e)   The system of looking at each unit as a stand-alone entity, without evaluation of the systematic linkages in order to have the macro level picture.

f)   Limitations such as limited access to information systems. Moreover, data extraction and its analysis are mostly manual. The use of software such as spread sheets/ database etc. is rare.

g)   Reporting system of audit findings is in the nature of fault finding.

h)   Inadequacy of compliance audit to address the risk areas,

i)   Inadequate Business Process Re-engineering in automated environment.

6.   Outline of new internal audit structure

6.1.   With a view to make the internal audit mechanism more   effective   and responsive   and   to incorporate   a   risk management framework which assists the MoD in oversight, an Audit Advisory Committee (AAC) has been constituted in MoD. AAC is multi-disciplinary body headed by Secretary (Defence Finance)/FA (DS) and has representation of   all   stakeholders in MoD   and the   Services Headquarters. Since the financial powers originally vest with Raksha Mantri (RM), the AAC reports to the RM through Defence Secretary. The functional paradigm of Internal Audit therefore consists of the following –

a. Assurance processes, effective risk management control and governance processes.

b. Consultancy services, thematic reviews and improvements in organizational operations.

6.2. The AAC will finalize the Annual Audit Plan by 15th February every year and submit it for approval of Raksha Mantri so as to be in place at the beginning of the new financial year i.e. 1st April. The AAC will hold at least two meetings in a year.

6.3. Based on the risk assessment of the vulnerable areas under the delegated powers, a risk profile for Defence related procurement will need to be identified. AAC may select one or more risk areas for inclusion in the Audit Plan. AAC may carry out a periodic review of this risk profile after every three years based on the experience gained over a period. The first Audit Plan approved by RM for 2015-16 consists of two Assurance studies and one Consultancy study.

6.4. Service-wise Internal Audit Teams (IAT) have been constituted by the CGDA to undertake the examination and evaluation of the adequacy and effectiveness of governance processes, risk management processes, internal controls structure, and the quality of its performance in carrying out assigned responsibilities. These activities will be carried out to provide reasonable assurance to the Government and higher management that these processes are functioning as intended to enable the organization to achieve its stated goals and objectives.

6.5 At the micro level, audit of sanctions by PCsDA/CsDA will be an effective tool to carry out risk analysis of individual procurement proposals and to provide assurance that all laid down procedures have been followed.

7. Methodology of Internal audit at the level of PCDA/CDA:

The Principal Controllers of Defence Accounts /Controllers of Defence Accounts (PCsDA/CsDA) functioning under the administrative and functional control of

the CGDA are responsible for internal audit. A PCDA/CDA is responsible for the audit of the portion of receipt and expenditure accounted for by him/her in other words, of transactions originating in the units/formations under his/her jurisdiction.

A) The audit activities are carried out on 'concurrent basis' at two levels as below:

(i) In the main office of a PCDA/CDA (including at Area Accounts Offices)- audit work related to sanctions issued by the lower formations below MOD and transactions arising out of such sanctions are carried out and

(ii) At the second level- audit of stores and cash accounts maintained by the Defence Services are done through LAOs/RAOs including audit of Service Books of Civilians, Check rolls in respect of Industrial Personnel employed in Depots etc. For this purpose, a number of LAOs or Assistant Local Audit Officers (ALAOs) have been co-located at stations/ areas within the audit jurisdiction of a PCsDA/CsDA with clear cut delineation of units and formations to be covered. In addition, dedicated LAOs/ALAOs for major store depots have also been provided. Similarly for audit of works expenditure, Regional Audit Officers have been provided.

B) Need to draw Charter for Internal Audit in DAD, which would serve the purpose of mandate, guidelines and methodology for audit and reporting standards in the Department.

The internal audit process comprise five main phases,

(i)   Planning the audit engagement;

(ii) Preparing for audit;

(iii) Performing the audit engagement;

(iv) Reporting upon the audit engagement; and

(v) Follow up action

C) The Audit Plan should be finalized and circulated by December month of the previous Financial Year. The PCDA/CDA should identify the Risk areas to be audited for that year in the LAO's Conference which should be scheduled before the finalization of Annual Audit Plan.

D) To review the relevance of prevalent Internal Audit Procedures against the backdrop of, Current International Standards and expectations of the Services. Suitable audit methodology to be developed and applied uniformly. There should be a shift in the concept of audit i.e. from the role of fault finding and fixing responsibility to enforcement of systems and controls and risk mitigation. Efforts should be to look at the internal controls of the executives & to concentrate less on detailed audit of such areas. Joint planning/ risk assessment to be done. Association of subject experts in the audit team to be considered.

E) Field Offices are facing difficulties in getting order/instructions of MoD/Services in time. HQ office has already nominated certain offices for rewriting/updating manuals for guidance of Auditors. These officers would be responsible for collection of all regulations, policy & procedure letters issued by MoD/Service HQ & issue compendium of such letters every year.

F) At present, internal audit of defence services is carried out as per the Defence Audit Code and various Local Audit Manuals for various wings of Defence Services. These codes and manuals lay down the scope, extent and detailed procedure for audit including the list of auditable documents and reporting mechanisms. These would need revision and updation as per the new practices. Revised Codes & Manuals should have drills for each type of audit. Drill for RBIA, Internal Control assessment, and IS audit should also be included.

G) In PAOs formal Internal Audit mechanism should be setup. Presently very informal review is being carried out. Like-wise for pension payments by DPDOs and banks, an effective internal audit mechanism using Computer Assisted Audit Tools (CAATS) needs to be put in place. As these functions are almost fully computerized, an internal audit system using Computer Assisted Audit Tools (CAATS) needs to be designed for this significant chunk of defence expenditure.

H)   Payment and Accounting of defence receipts and expenditure is the responsibility of DAD for which internal business processes and checks have been prescribed in various Office Manuals (OMs) and Codes. These responsibilities are carried out by various sections in the PCDA/CDA-main office and in sub-offices i.e. AAOs/PAOs. Presently, internal audit check on the work carried out by these sections through an agency independent of pay and accounting sections, has not been prescribed nor has the need of it been recognized explicitly barring in few cases. A mechanism should therefore, be designed to audit the processes followed and accounts/documents maintained by these sections.

I)   To bring uniformity in working and share work experience a Service wise cluster and common database needs to be formed. The kind of clusters are:

Cluster A- Comprising of all PCDA/CDA cater to Indian Army

Cluster B- Comprising of all PCDA/CDA cater to Indian Air Force

Cluster C – Comprising of all PCDA/CDA cater to DRDO

Cluster D- Comprising of all PCA/CFA cater to Ordnance Factories

Cluster E- Comprising of PCDA (Navy) & his subordinate & associate offices dealing with Indian Navy.

8.   Audit by LAO/RAO

It is the responsibility of Executives i.e. various Supply and Stores depots and the units and formations in so far as

a)   Preparation and maintenance of accounts of stores i.e. Ledgers, returns, stock and due sheets and/ or such other records connected with the receipt and issue of stores as may be prescribed for the purpose in various books of regulations such as Stores Accounting Instructions and other Government orders issued from time to time for each class of depot or unit/formation.

b)   Undertaking the physical verification of stores periodically.

c) It is the duty of the Defence Accounts Department to carry out internal check of these accounts locally and to see that stock verification and reconciliation exercises are being conducted as provided. The aforementioned internal checks are being done through the LAOs, who have defined audit jurisdictions. LAO's job is to ensure completion of audit and also to review and test check audit done by his/her staff. The main audit processes involved in the audit by LAO are

    (i) Verification of 'castings', closing book balances and opening book balances

    (ii) Linking on the receipt side, of transfer inward and of purchases and on the issue side, of transfer outward

    (iii) Audit of Final Receipts and final issues

    The audit is carried out to the extent prescribed from time to time by the CGDA.

d) Audit by LAO is in true sense internal audit function as it is in the nature of check by an independent agency on Stores and Cash Accounts maintained by the units/formations (i.e. Auditee organization). Internal audit of Inventory systems involving Receipt management, Inventory stacking, Issues management and stock reconciliation is a standard internal audit activity for any organization, particularly in production organizations.

The activities like checking of casting, verification of opening and closing balance linking of receipt and issue vouchers in the stores ledger may appear routine and pedestrian audit exercise but its importance and criticality can be gauged from its impact on organization as below:

    (i) It is very essential to ensure that stores for which payments have been made have been received in good condition, as paid for and has been accounted for in the stores ledger. Inadequate/incorrect receipt management and accounting can lead to short receipt or non-receipt of stores paid for and/or fictitious payments resulting in loss of public money.

(ii) Issues made without requests/indents or without authorization resulting in incorrect despatch leading to misutilization, frauds and wastages.

(iii) Delays in issues impact operational efficiency and also lead to unnecessary local purchases.

(iv) Inaccurate updation of inventory ledgers can result in incorrect stock position, which may lead to

aa. Unnecessary purchases and financial pay-outs.

bb. Loss of money due to inadequate stock holding procedure.

cc. Holding of stock for a long period implies blockage of funds.

(v) It leads to unnecessary purchases and financial pay-outs for such procurement.

8.2. As the Armed forces hold large inventories and huge financial payouts go into purchase of stores and supplies, stores accounting and associated inventory risks are high in the defence services. Therefore, audit by LAO is a mechanism to provide reasonable assurance about inventory risks.

8.3. Similarly, audit and inspection of Cash Accounts of the units/formations by LAO provides assurance on cash handling by the auditee organization.

8.4 Before commencement of the Financial year, the team leader/officer in-charge of audit office should divide the audit work among his staff/officers. The work distribution should be recorded. The Protocol for conducting Internal Audit and Format for Audit Report at field offices is given at **Annexure A.**

8.5 The scope of audit could be varied depending upon importance and functioning of the unit. The existing scope and percentage of audit in certain areas like clothing, ration, service book, MT, checking of casting of ledgers etc., can be reduced or stopped at AAOs level. This will free the LAOs to utilise their time, productively, for carrying out specific Systems and other studies. Other areas like issue and receipt of stores etc. may warrant greater focus.

8.6 Scope and extent of audit should be re-looked at, based on risk perception associated with units and formations. For example, extent of audit of Supply and Stores depots and consuming units/formations should not be identical. Further, activity like casting check can be dispensed with as maintenance of ledger has been more or less computerized.

8.7   Performance parameters may be introduced for evaluating the efficiency effectiveness of Local Audit.

9.   Methodology of audit of sanctions

9.1.1. In respect of sanctions and orders, affecting Defence Services, issued by authorities lower than Government of India, it is seen that the sanction is accorded by a competent authority covering the expenditure. The sanction may be either specific to the expenditure (i.e. special sanction) or it may be a general sanction. At the micro level, audit of sanctions by PCsDA /CsDA under CGDA is an effective tool to carry out risk analysis of individual procurement proposals and to provide assurance that all laid down procedures have been followed.

9.1.2. There is a need to enlarge the scope of audit of sanctions. It should not be confined to sanction orders/letters, as that would merely lead to detection of clerical   mistakes, which is not worth the effort. There is a need to focus on complete cycle leading to sanction and transaction thereafter. The audit of sanctions necessitates specialized knowledge. The sanctions need to be issued in uniform formats and should be received in advance.

9.1.3. As there has been a quantum jump of audit workloads in PCsDA/CsDA over the years. At the same time manpower available with the Department has continuously been going down. Apart from this, most of the CFA's are not conveying decisions taken by them in the form of sanction letters, as prescribed in DPM. Three Services HQrs, BRO, DRDO etc. shall be requested to comply with DPM strictly in this matter and send the sanctions in a serial order to concerned

PCDA/CDA in time to ensure advance or concurrent audit to ensure that while subsequent payments are not delayed, interest of state is also safeguarded. Internal Audit of sanctions is expected to improve: with strict compliance of service HQrs with DPM/GFR provisions. Internal Audit wing of CGDA office would frame norms & guidelines both for Service HQrs and PCsDA/CsDA to organise timely Audit of Sanctions to make it meaningful w.r.t. nature of sanctions/risk profile of the services etc.

9.2. **New approach to Audit of Sanctions**

Audit can be done with reference to documents kept in the units and formations issuing the sanctions and as such audit done with respect to documents received in the PCsDA/CsDA doesn't allow deeper examination of the processes followed during the purchase and its impact on purchase objectives.

9.2.1. As per extant procedure, audit of Sanctions to expenditure is required to be carried out in advance but at present, audit of sanctions is generally being done on receipt of bills/vouchers in most of the offices. This sometimes leads to delays in payment, Further since internal audit of sanctions and/or expenditure is done as a part of payment and accounting processes, payments are sometimes withheld/stopped by the PCDA/CDA on the grounds of breach of audit processes.

Whereas audit of sanctions authorising expenditure out of public exchequer is required to be done normally before materialisation of supplies, this is somehow not done because of non-receipt of sanctions and connected documents. In most of the cases, despite orders contained in Defence Procurement Manual various CFAs are not converting their decisions into formal sanctions for issue in a serial order. Even if these sanctions are issued, these are sent only along with the bills of suppliers for payment. Sometimes defects in the decision making process and in the sanction letter obliges Controllers to raise observations. This causes delays in payments on account of breach of either canons of financial propriety or on account of violations of tender rules and procedures or any other ground. This

causes withholding or stopping of payments by PCsDA/CsDA despite availability of funds in the concerned budget code head. Whereas, the matter is being taken up with Service HQrs/MoD for timely issue of sanctions in all cases of decisions taken by CFAs under power delegated to them, payments shall not generally be withheld if funds are available and if goods and services have been delivered accepted and accounted for in the accounts of unit concerned. To reiterate payments on account of contractual commitments where goods & services have been delivered & accepted by competent authorities & also accounted for in store accounting system and provided where the requisite terms and conditions prescribed in the contract for release of payment have been complied with, should not normally be delayed on the ground of deficiencies noticed in the process of conclusion of contracts or its execution. However notwithstanding payments made, deficiencies noticed need to be reported to next higher CFA/CGDA through various reports like MFAI & IAR etc.

9.2.2. Further as the internal audit of indents and purchase order processes can be effectively done only with reference to various records maintained by the purchasing authority, an appropriate audit mechanism - whether by detailing audit teams from the Main Office or by revamping Local Audit to include audit of sanctions in their charter at the time of receipt audit- needs to be devised with defined scope and extent. A 360 degree overview can be achieved by clear definition of the scope of audit and then correlating the audits conducted by the PCsDA/CsDA located at various locations. Accordingly, the Internal Audit wing of CGDA should define the scope of audit based on risk probability, materiality etc as well as the audit methodologies to be adopted by PCsDA/CsDA while conducting their audit. The quantum of audit to be conducted as percentage of total transactions may also be defined by internal audit wing of HQ office.

10.   Product of IA

10.1. The product of internal audit includes

a) Audit observations issued to the units as a result of verification of castings, closing book balances and opening book balances, Linking on the receipt side, of transfer inward and of purchases and on the issue side, of transfer outward, Audit of Final Receipts and final issues etc.

b) MFAI -Reveals systemic flaw, grave violation of rules and regulations, loss of substantial amount due to theft, fraud or neglect. It is prepared quarterly. It is addressed to the GOC-in-C for Army, Command HQrs, Departmental heads with a copy to DGADS.

c) Internal Audit Report- Prepared on half yearly basis since 1994. Submitted to Secy (Def /Fin)/FA (DS), Defence Secretary, PSO's in Service HQrs.

d) Annual Audit Certificate-Forms a part of the Annual Appropriation Accounts, submitted to Secy(Def Fin)/FA(DS).

e) Assurance and Consultancy reports of internal audit- Service-wise Internal Audit Team (IAT) constituted by CGDA under Annual Audit Plan to undertake the examination and evaluation of the adequacy and effectiveness of governance processes, risk management processes, internal controls structure, and the quality of its performance in carrying out assigned responsibilities. These activities will provide reasonable assurance to the Government and higher management that these processes are functioning as intended to enable the organization to achieve its stated goals and objectives.

10.2. IA report need to be consolidated issue-wise, command-wise at CDA level and issue-wise, organisation-wise at CGDA level. In case of Ordnance Factories, consolidation of objections issue wise/Factory/operating division wise consolidation of objections is required to be done.

Separate IAR   (i) Services, DRDO etc.

                (ii) OFB, PSU

Issue based IAR   (i) Pay, Personal entitlements, Pension

                (ii) Procurement of stores

(iii)Works

Format for Internal Audit Report (IAR) may be as follows

IA objection Report Number : number and quarter		
	Name of the Establishment/Command/Factories/Labs involved	
	A	Number of major objections and minor observations
	B	Financial value/Loss etc. (If any):
	C	Audit team members and Duration of audit
	D	Executive Summary
	E	Details of previous outstanding objections
	F	Each objection in the report to reflect the following
		a) Objective: Scope, Approach, Data:
		b) Background :
		c) Irregularities involved : i) ii)
		Relevant Rules/Orders on the subject :
		Audit suggestions for rectifying the irregularity and for improved in the systems and procedures : i) ii)
		Letter number and date under which objection referred to Executive Authority Concerned.
		Signature : Date :

11.   Capacity building

11.1. Capacity of DAD staff would need strengthening to efficiently and effectively implement the revised charter of internal audit in MoD.

a) There is a need to build up sufficient numbers of trained manpower. Audit is under resourced and auditors inadequately trained, resulting in the output being highly compromised. The capacity of auditor needs to be enhanced, through training, appropriately designed job description sheets, toolkit and manuals including on-line help facilities. Multi-disciplinary teams should be constituted for audit. The issue of inadequate man-days should be looked into duly taking into account automation of inventory and logistics systems

by Defence forces and automation of LAO's offices in future. Man-days for audit should be reviewed and some flexibility allowed at the discretion of the LAOs. Code of Ethics for Internal Auditors to be put in place.

b) Computer Assisted Audit Techniques and Tools to be used for internal audit i.e. computer assisted system of data extraction and analysis. Meaningful MIS to be created for effective audit. Automation of cash and stores audit to be done by working through executive system. This would free manpower to conduct higher audit. Suitable technical skill to be developed in IT/IS audit by sending officers/staff for professional courses.

c) Educating the staff in the writing of audit reports. The terminology to be used while writing these reports to be more acceptable. There is a need to use language which does not appear offensive and negative ie. to change from the fault-finding, objection oriented attitude to a more enabling role of recommendations or suggestions and a solution finding approach. A Standard Template of Audit Report may be formalized Service wise (Cluster wise) and circulated amongst PCsDA/CsDA.

12.   Revised charter to include compliance audit

The audit function is being carried out by the Department on behalf of the C&AG. Transaction and compliance audit need to be carried out by incorporating provisions of risk based techniques which would provide necessary focus and direction. The following measures will be useful:-

12.1 **Audit Committees:** Audit committees need to be set up at Command Level and in Factories at OFB level with Executive authorities on board to ensure interaction of stakeholders on regular intervals i.e. an institutionalized mechanism for interaction with the executives (atleast twice in a year). Greater commitment from top executives is felt necessary. Commitment to effective internal control

should be reflected directly in the importance executives attach to its internal audit function like joint planning/ risk assessment.

The responsibility of this Audit Committee should be as follows:

a) Intervene where data and documents are not made available to the IA.

b) Nominate link officers at every level for co-ordination and smooth functioning.

c) Help finalise Risk Areas for audit during the year

d) Monitoring progress of audit in the Command, OF Board

e) Ensuring Compliance action and settlement of objections within three months and at the most 6 months by the auditee.

f) Ensuring recovery follow up action.

g) Initiate action in improving systems and procedures (where ever required) based on the internal audit reports

h) Meetings to be held quarterly

i) To shift the concept of audit i.e. from the role of fault finding and fixing responsibility to enforcement of systems and controls and risk mitigation.

12.2**. Audit Plan:** An Audit Plan should be finalized and circulated by December of the previous Financial Year by the PCsDA/CsDA. The PCsDA/CsDA in consultation with executives in the Audit Committee should identify the Risk areas to be audited for that planned year. The instruction for audit of Risk areas should also be circulated along with Annual Audit Plan by the PCsDA/CsDA. The Audit officials should be clear about the areas to be audited. Necessary training should be provided to the audit teams in the audit of selected areas by the CGDA/ PCsDA/CsDA.

12.3. Categorisation of the risk: An illustrative list of some of the internal risk areas faced by Government today as highlighted in Department of Administrative Reforms and Public Grievances (DARPG) framework, some of which would be applicable to areas under the delegated powers, are as follows -

a)   Failure of sellers or other agencies to provide services as required;

b) Project delays, cost overruns, and inadequate quality standards;

c) Delayed or failed introduction of new technology;

d) Loss or misappropriation of funds through fraud or impropriety;

e) Inadequate skills or resources to deliver services as required;

f) Disruption from industrial action, protest, or failure of transport or

g) IT infrastructure;

h) Inconsistent programme objectives resulting in unwanted outcomes;

i) Inadequate contingency plans to maintain continuity of service delivery;

j) Failure to evaluate pilot projects properly before a new service is introduced may result in problems when the service becomes fully operational;

k) Failure to innovate leading to sub-standard services;

l) Violation of DPM, Deviation of procedures,

m) Fraud Cases- Travel and pay claims,

n) Loss to State due to – Inefficient/Poor Planning and Irregular procedures

o) Non-recovery of dues/revenue

p) Blockage of Government Funds

q) Non/Poor utilization of Stores

r) Overpayments by Units

s) Outstanding advances,

t) Non report of service receipt,

u) Life certificate of pensioners,

13.   Information Systems Audit

13.1 Information Systems Audit (also called IT Audit): It is an examination of the management controls within an Information technology (IT) infrastructure of the Auditee organization. IS Audit is defined in the Information System Audit Manual of C&AG as:

'the process of collecting and evaluating evidence to determine whether the computer system (of auditee) safeguards assets, maintains data integrity, allows organizational goals to be achieved effectively and uses resources effectively'.

The evaluation of obtained evidence determines if the information systems are safeguarding assets, maintaining data integrity, and operating effectively to achieve the organization's goals or objectives. Information Systems audit has assumed importance in the context of various initiatives taken by the Government to usher in an era of e-governance (which refers to the use of information and communication technologies to support good governance). A key factor in the implementation of e-governance is the identification of appropriate hardware platforms and software application packages for cost-effective delivery of public services. Information Systems audit would cover the following areas:

- Systems and Applications:
- Information Processing Facilities
- Management of IT
- Client/Server, Telecommunications, Intranets etc.

13.2   The objective of undertaking an IS audit is to evaluate computerized information system (CIS) of auditee in order to ascertain whether the CIS produces timely, accurate, complete and reliable information outputs, as well as ensuring Confidentiality, integrity, availability and reliability of data and adherence to relevant legal and regulatory requirements. Objectives include:

a) Ensure asset safeguarding. Assets are:

(i)   Data

(ii) Application systems and programs

(iii) Technology: Hardware, operating system, database etc.

(iv) Faculties at IT Centre

(v)   People: Skills, safety, awareness etc.

b) Maintain attributes of data or information:

(i)   Effectiveness: Data should be relevant and correct, usable and delivered timely.

(ii) Efficient utilization of resources

(iii) Integrity of data: Valid, accurate and complete data.

(iv) Availability: Data available to those authorized and is safeguarded against theft, fire, virus, unauthorized access, tempering, hacking etc.

(v) Compliance: System within ambit of rules and regulations.

(vi) Reliability of information: Appropriate information to users.

Audit is required to examine whether IT processes & IT resources combine together to fulfill intended objective of the organization and ensure Effectiveness, Efficiency and Economy in its operations while compiling with the extant rules.

Further, it is emphasized that the Information system audit should start functioning from the day the functioning of the executive authorities is shifted from manual to computer base system, HQ office shall bring out this requirement to the notice of the each of the executive authority, Training division of HQ office shall may impart training to the newly posted officers and staff and before entrusting this kind of audit assignment of IS auditors.

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Protocol and methodology for Conducting Internal Audit

Internal Audit should familiarize itself with the business processes of the Auditee organization and also the database available with them. The protocol to be observed by Internal Audit Team while dealing with the Auditee organization during the course of the Internal Audit is given below:

a). **Commencement:** Before commencement of audit, the concerned Unit/ Formation/ Factory/ office should be informed about the schedule of audit. A Commencement letter should be sent to Head of the auditee department at least a month before starting audit. It should contain, purpose, scope and period covered and duration of audit. Team members involved details about entry conference and request for data, documents to be provided.

Entry Conference

Internal Audit commences with an entry conference, by meeting the key personnel of the auditee organization including the Head of the Office. The scope and flow of activities of the audit are communicated, so that auditee makes necessary arrangements for effective conduct of audit. The plan and the methodology of the audit may be discussed for better communication and required support from the auditee.

During the entry conference, the team leader should:

(i) Introduce the team members and explain the scope and methodology of the audit.

(ii) Discuss the Risk areas identified, describe the process of raising the audit queries and their finalization including the time line for replies to be received from auditee;

(iii) Request for the support (production of records, prompt response to audit queries, etc.) that is needed and also ask for action taken on previous objections for verification;

(iv) Identify the information/records that would be needed and ask Executives/management to give details of Nodal Officer and contact officers for each establishment/section;

(v) Elicit the concerns, questions and suggestions of the auditee.

The entry conference sets the tone for effective audit by establishing effective communication lines with the auditee unit. It also helps the internal auditor to validate the information he had gathered during the planning stage and assess the attitude and perception of the key personnel towards controls. The minutes of the Entry Conference should be recorded. The team leader should review the progress of audit and also the review the audit plan.

b). Gathering Evidence and Information.

The following are the methods for gathering information and evidence:

i). **Inspection:** Examination of the documents underlying transactions most commonly known as vouching. Physical verification generally applied in case of assets to assert that asset exists.

ii). **Observation**: Seeing or watching activities or facilities. Generally assets and processes are observed. Examples include entry of unauthorized persons into computer room, checking log entry of e-procurement package. Written or oral replies from the management.

iii)**. Sampling**: There are various methods for sampling. Audit Software's help in extracting samples as per requirement.

- **Random Sampling:** Random Record Sampling can be used to generate a database of random records taken from an input database. Random Record Sampling is a common means of sampling. With this method,

you enter the sample size as well as the range of records from which the sample is to be extracted to a separate database.

- **Systematic Record Sampling** is a method of sampling used to extract a number of records from a database at equal intervals (for example, every 1000th record). Eg. Every fifth supply order.

- **Stratified random Sampling** is used to extract a random sample with a specified number of records from each of a series of bands. This method requires the database to first be stratified into a series of numeric, character or date bands. Eg. Highest amount of sanctions.

- **Attribute Sampling** refers to the examination of a subset of a population (a sample) in order to assess how frequently a particular event or attribute occurs in the population as a whole. An attribute has only two possible values: true or false. In auditing, typical attributes are: if an item is in error or not; if a particular control is exercised when it should be; if the entity compiled with a particular law.

- **Sort:** Sort task may be used to create a new database in which its records are physically sorted in a specified order. If you require the records in a database to be sorted but do not wish to create a new database, use the Indices task. Eg. Sorting item code or nomenclature wise to extract splitting.

iv. **Analysis and Review**: A principal means through which internal auditor conducts the audit function is through careful analysis and critical review of both financial and operating data. Comparison of current account figures with past period will alert auditor to unusual variances. Audit software help in faster analysis of bulk data which cannot be done manually.

vi. **Scanning**: This is a process of quickly but carefully scrutinizing database, ledger account, document, or any other record for questionable, unusual

or improper items. This is the most useful technique while examining accounting records and information and splitting cases.

c.) Concluding Audit

The audit is concluded once all the audit procedures and checks are completed. The internal audit team leader should finally review the working papers to see that the audit has been **conducted** according to plan and it has achieved its objectives. He/she should make note of any audit procedures that could not be completed because records were not produced by the auditee or due to lack of time. Team leader should decide whether all audit observations would find place in the report or some would be dropped in view of the replies received during the course of audit. He/she should check the supporting evidence for each observation that is proposed to be put in the report.

d.) Draft Internal Audit Report

Team leader should satisfy himself about the sufficiency and relevance of the evidence. He should then prepare a draft report which will include his report on Effectiveness of controls and any major / minor weaknesses in them; Non-compliance with law, codes and government orders with assessment of possible loss and any matters relating to propriety of transactions. The format of the draft report shall be same as final report and all the applicable quality checks equally hold good for draft report also except that the title of the report shall be "Draft Internal Audit Report".

e.) Exit Conference

Request for exit conference should be made through a formal letter to the management enclosing the draft audit report, giving sufficient time to auditee and his team to study it and prepare themselves for the meeting. The purpose of exit conference is to give the department an opportunity to place additional facts, its views etc. on the audit findings. Essentially, it is an opportunity for internal auditor to seek confirmation of facts given in the audit report and the

department's views on the audit recommendations. **If the exit conference takes place in right spirit, the audit report becomes an agreed document between the auditee and the internal audit.** Minutes of the exit conference should be recorded and a copy may be given to the auditee for their information.

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