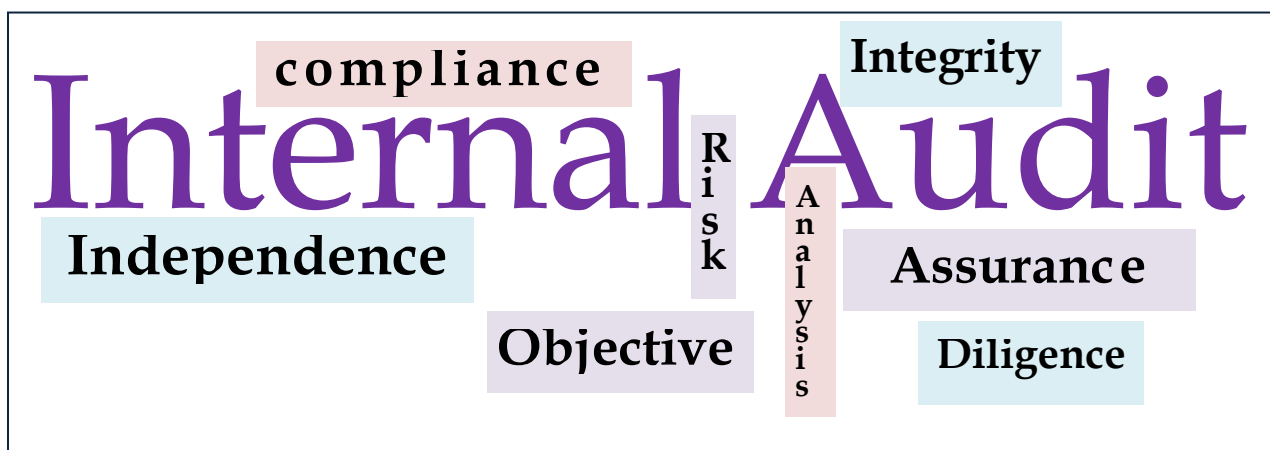


Manual for Internal Audit in Indian Railways



**MINISTRY OF RAILWAYS
(RAILWAY BOARD)
GOVERNMENT OF INDIA**



Code of Conduct of Internal Auditor

Internal Audit Cell shall be committed to work with integrity, objectivity and thoroughness in discharge of their duties and responsibilities. Internal Audit Wing holds the trust of the Railways management and shall exhibit complete commitment and loyalty towards the organisational goal of Railways.

Manual For Internal Audit on India Railways

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Chapter 1

INTERNAL AUDIT A CONCEPTUAL FRAMEWORK

Audit, both external and internal, have traditionally been tools for monitoring and analysing all activities of an organization and reporting on deviations from rules and regulations for a focused review, corrective measures and enhanced decision making. Audits can be classified into the following three broad categories:

Internal Audit is aimed at evaluating the adequacy and effectiveness of risk management, governance and control processes thereby adding value and improving an organizations.

Compliance or the Regulatory Audit: The audit which focuses on assessing the extent to which rules and regulations formulated by the organisation are followed is called Compliance or the Regulatory Audit.

Financial Audit: The audit which provides the assurance on the financial statements of the organisations are commonly referred to as the Financial Audit.

Performance Audit: The audit which focuses on improving the performance of the organisation by examining whether programmes, projects and services achieve the principles of economy, efficiency and effectiveness is commonly referred to as the Performance Audit.

1.1 Management of Internal Audit in Government

The need for an Internal Audit function in Ministries and Departments primarily stems from the need for concurrent audit for taking corrective measures, improving accountability, ensuring

compliance with rules, regulation and providing feedback to Management through periodic review of internal controls. The basic function of an internal audit practice is thus “measurement and effectiveness of controls”. A situation where internal audit is both a part of the internal control system and is also required to comment on adequacy and effectiveness of other internal controls places it in a unique position.

Thus, internal audit aids Management by providing a periodic feedback about functioning of internal controls and suggesting measures to strengthen them.

1.2 Internal Audit- Definitions

INTOSAI (Internal Organisation of Supreme Audit Institution) standard ISSAI 1003 (International Standards of Supreme Audit Institution)

- Internal audit function is an appraisal activity established or provided as a service to an entity. Its functions include, amongst other things, examining, evaluating and monitoring the adequacy and effectiveness of internal control

Institute of Internal Auditors of UK and Ireland

- Internal Auditing is an independent, objective assurance and consulting activity designed to add value and improve an organisation’s operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance process

CIPFA

- an appraisal activity estimated or provided as a service to an entity. It functions include, amongst other things, examining, evaluating and monitoring the adequacy of internal control

To design an efficient and effective internal audit function in government, it is necessary to ensure that practices meet widely accepted norms.

Internal Audit is an assurance function that primarily provides an independent and objective opinion to the organization on the control environment comprising risk management, control and

governance by evaluating its effectiveness in achieving the organisation's objectives, in a concurrent manner.

Institute of Chartered Accountants of India	
• Internal Audit is an independent management function, which involves a continuous critical appraisal of the functioning of an entity with a view to suggest improvements thereto and add value to and strengthen the overall governance mechanism of the entity, including the entity's strategic risk management and internal control system	It objectively examines, evaluates and reports on the adequacy of the internal control environment for proper, economic, efficient and effective use of resources

The boxes give the definition of Internal Audit by different organisations. All the definitions visualize internal audit practice as a function aimed at evaluating the adequacy and effectiveness of risk management, governance and control processes, thereby adding value and improving an organisation's operations. In the context of government and public sector functioning, it is equally important to acknowledge that serving public interest must be the overriding objective guiding these operations.

1.3 Internal Audit- Focus

Traditionally, the focus of internal audit has been on compliance with rules, regulations, policies and procedures. As is evident from the definitions above and from the role assigned to the Internal Audit Wings in the "Redefined Charter for Financial Advisors" issued by Ministry of Finance on June 1, 2006, the remit of Internal Audit has been enlarged. While Compliance Audit remains important, internal auditors are now expected to focus on evaluation of controls with reference to the risks and to provide an assurance to the Management that the controls are functioning in the intended manner and hence there is a reasonable assurance that the goals and objectives of Ministry/Department will be achieved. Through this, Internal Audit contributes to the efforts to strengthen governance processes in Ministries/Departments.

Compliance Audit is important, but internal auditors are now expected to focus on evaluation of controls with reference to the risks and provide assurance to the Management that the controls are functioning in the intended manner and there is a reasonable assurance that the goals and objectives of Ministry

achieved.

In performance of both these services, Internal Audit is expected to focus on assessing whether governance, risk management and control processes provide reasonable assurance that:

1. Significant financial, managerial, and operating information is accurate, reliable, and timely.
2. Resources are acquired economically and used efficiently.
3. Assets are safeguarded.
4. Actions of the organization are in compliance with policies, procedures, contracts, and applicable laws and regulation.
5. Significant programs, plans, and business objectives will be

1.4 Internal Audit Process

The internal audit process comprises of five action phases.

1. Planning the audit engagement.
2. Preparing for Audit.
3. Performing the audit engagement.
4. Reporting upon the audit engagement; and
5. Follow up action.

A typical internal audit assignment involves the following steps:

- 1) Establish and communicate the scope and objectives for the audit to appropriate management/authorities.
- 2) Develop an understanding of the operational area under review. This includes objectives, measurements and key transaction types. This involves review of documents and interaction with the auditee. Flowcharts and narratives may be created if necessary.
- 3) Describe the risks facing the business activities within the scope of the audit.
- 4) Identify control procedures used to ensure each key risk and transaction type is properly controlled and monitored.
- 5) Develop and execute a risk based sampling and testing approach to determine whether the most important controls are operating as intended.
- 6) Report problems identified and review action plans with management to address the problems.
- 7) Follow-up on reported findings at appropriate intervals for which Internal Audit departments must maintain a follow up database.

Internal audit is a concurrent process and may not involve the detailed audit process, unless it is a specific theme based audit, undertaken as a special audit. By analyzing and recommending business improvements in critical areas, auditors help the organization to meet its objective. In addition to assessing business processes, Information Technology (IT), Auditors also review information controls.

1.5 Entry Conference

Internal Audit engagements normally start with an entry conference, a meeting between the internal auditors and the Head of Department/ Head of Office of the organization being audited. The primary purpose of this meeting is to establish an appropriate environment for the audit. In this meeting, internal auditors communicate the proposed objectives and scope of the audit engagement and seek to understand the objectives and risk management practices in the organization. Issues or areas of special concern that the management/ auditee would like audit to address and logistical details (nodal officer to coordinate audit requirements of space, records, meeting etc.) are also discussed in the entry conference. Thus, the audit objectives, detailed scope, approach and testing plan for performing the

Sequence of Activities for Internal Audit

1. ENTRY CONFERENCE
2. AUDIT EVIDENCE
3. AUDIT OBSERVATIONS
4. AUDIT WORK PAPERS
5. DRAFT REPORT
6. EXIT CONFERENCE
7. FINAL REPORT
8. ACTION TAKEN REPORT

audit, communication and reporting strategy are identified along with the organization's representative who would be responsible for coordinating management action plans and monitoring the status of implementation of recommendations.

The entry conference sets the tone for audit by establishing effective communication lines with the auditee organization. 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.

1.6 Audit Evidence

Audit evidence is the information collected, analyzed, and evaluated by the auditor to support an audit observation. Audit evidence relates both to the quantity and quality (or reliability) of evidence to be obtained by auditors. It is important for auditors to obtain sufficient, appropriate and reliable audit evidence to enable them to draw reasonable conclusions on which to base their audit opinions. Sufficiency is the measure of quantity of audit evidence while appropriateness refers to reliability of the audit evidence and its relevance to a particular assertion. Evidence is considered appropriate when it is both relevant and reliable.

1.7 Development of Audit observations

Audit observations emerge through a process of comparing “what should exist” (the audit criteria) with “what exists” (the audit evidence). When there is a difference between “what exists” and “what should exist,” the auditor assesses the effect, impact and cause associated with the variance and documents it as an observation. The accumulation of observations provides the auditor with the necessary foundation on which to develop the audit engagement conclusions, recommendations and audit report.

Documentation of Internal Audit

- 1) Audit Work Papers
- 2) Permanent Audit File'
- 3) Current Audit File

1.8 Audit work papers

Audit work papers are documents either created by the auditor or gathered by him during the audit engagement. They record information to support the conclusions and audit results and hence reflect on the quality of audit conducted. The working

papers aid internal auditors in planning, performing and supervising audit work. Working papers are also a good source of evaluation of the internal auditor's work by external auditors and for peer review.

Working papers are contained in two types of files: permanent audit file and the current audit file.

1.9 Permanent Audit File

Permanent audit file contains information that is relevant to current and future audits as it consolidates all important documents at one place. It also provides a basis for consistency in testing and allows comparison of key performance indicators over time. Permanent audit files typically include (i) organizational chart; (ii) description of schemes, programs, systems, procedures and business plans; (iii) corrective action plans; (iv) legal and regulatory issues impacting the organization; (v) risk assessment; (vi) correspondence of continuing future audit; (vii) updated audit programmes.

1.10 Current Audit Files

Current audit files contain record of the audit work schedules and documents relevant to the current audit. These should represent a clear record of the audit processes, procedures, findings, conclusions and reports. Current audit files typically include (i) copies of the draft and final audit reports; (ii) significant findings and issues identified during the audit and how they were resolved; (iii) audit planning documentation; (iv) administration/ correspondence documents; (v) follow-up of previous audit reports; (vi) updated audit programmes; (vii) supporting documentation for the audit conclusions; (viii) minutes of entry and exit meeting.

1.11 EXIT CONFERENCE

The Internal Audit team should discuss with the senior Management of Zonal railway including GM, PHOD regarding the findings, observations, recommendations, and text of the discussion draft. In this conference, the management should comment on the draft and

the Internal Audit team should work to achieve the consensus and reach an agreement on the Internal Audit Findings

1.12 FOLLOW-UP ACTIONS

The true achievement of an audit engagement is reflected in implementation of the recommendations and an improved control system. The importance of this phase should therefore not be underestimated. The detailed manual should bring out a procedure for developing and monitoring of significant internal audit observations and issues raised. Clearly defined systems should be laid out.

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## CHAPTER 2

### SCOPE OF INTERNAL AUDIT IN GOVERNMENT DEPARTMENTS

#### 2.1 EVOLUTION OF INTERNAL AUDIT IN GOVERNMENT

1. The Civil Accounts Manual and the Inspection Code issued by the Controller General of Accounts prescribes and codifies the scope of internal audit functions for all the Central Ministries of Government of India. These functions for the State Governments are prescribed by the Accountant General's in the States. However, Ministry of Defence,

**The evolution in the role and responsibilities of the Central Ministries has necessitated the need to put in place and effective Internal Audit systems in Government Departments.**

Railways and Postal Department have a unique position, as the internal audit functions in them are governed by their Codes and Manuals, led by the officers from organised accounting services namely Indian Defence Accounts Service (IDAS), Indian Railways Accounts Service (IRAS) and the Indian Post and Telecommunication Accounts and Finance Service (IPTAFS), respectively.

2. The role and reach of central civil ministries has evolved both in terms of greater geographical area and scope. With the expansion and change in institutional delivery mechanisms and increasing focus on transparency and accountability, the expectations from Internal Audit are also undergoing change. It is thus necessary that internal audit should also evolve and adapt itself to both the internal and external environments.

3. To align the objectives of Internal Wings with strategic objectives of the Ministries, the Ministry of Finance, Department of Expenditure vide its O.M. F.No. 5(6) dated June 1, 2006 issued the "Redefined

Charter for Financial Advisers”, acknowledged that the Institution of Financial Adviser (FA) occupies a unique position in the functioning of Government of India and promulgated the role of Integrated Financial Adviser. It detailed the role and responsibilities of the internal audit wing working under the control and supervision of Chief Controller of Accounts (CCAs)/Controller of Accounts (CAs). It further stipulated that internal audit should move beyond the existing system of compliance/regulatory audit and focus on:

- 1) Appraisal, monitoring and evaluation of individual schemes.
- 2) Assessment of adequacy and effectiveness of internal controls in general, and soundness of financial systems and reliability of financial and accounting reports in particular.
- 3) Identification and monitoring of risk factors (including those contained in the Outcome Budget).
- 4) Critical assessment of economy, efficiency and effectiveness of service delivery mechanism to ensure value for money.
- 5) Providing an effective monitoring system to facilitate mid-course corrections.

Internal Audit Wings can serve as an effective tool for providing objective assurance and advice that add value, enhance governance, assist risk management and control processes and improve accountability for results oriented managements.

## **2.2 CHECKS CONDUCTED BY INTERNAL AUDIT**

The use of checklist ensures a high degree of standardisation, compliance, consistency, completeness and quality.

The checks conducted by Internal Audit will include checking of initial accounts maintained in the executive offices to ascertain compliance with rules and regulations, systems and procedures in accounting and financial matters. The scrutiny should, inter-alia, cover loans and advances, disposal of confiscated stores, review of installation and operating efficiency of expensive equipments and

machinery, examination of records relating to physical verification of stores, equipments/tools and plants, assessment of adequacy and effectiveness of internal controls, critical assessment of economy, efficiency and effectiveness of service delivery mechanism to ensure value for money so as to facilitate and ensure mid-course corrections.

The extensive presence and use of checklists across Ministries/Departments assures that highest standards relating to format, consistency, completeness, quality and presentation are achieved. The checklist simplifies the auditor's tasks and also contributes to the objectivity of internal audit process.

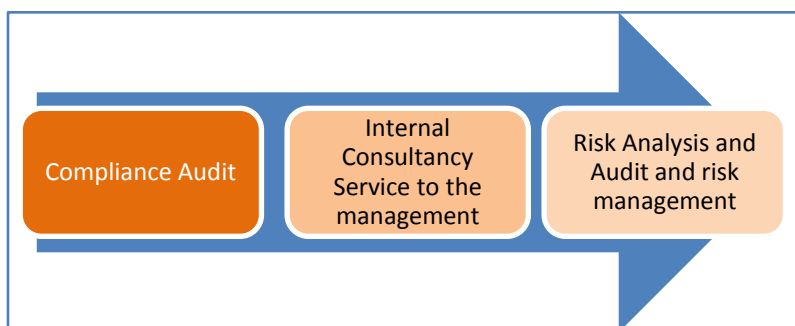
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CHAPTER 3

STATUS OF INTERNAL AUDIT IN INDIAN RAILWAYS

Internal Audit in Indian Railways is as old as the Acworth Committee which recommended “*subject to independent audit by Government of India, the Railways Department should employ its own accounting staff and be responsible for its own accounts.... (Paras 129-134 of Acworth Committee Report)*”. These recommendations, and the large financial responsibilities led to the establishment of the office of the Financial Commissioner, who with his team, discharges the functions of internal audit with integrity, objectivity and sincerity in alignment with the organisational goals and in compliance to various Railway Codes and Manuals.

The Preface to the Accounts Code broadly mentions about the Organisation, Book-keeping and the Internal Check & Disbursement by the internal Auditor of the Railways. Internal audit wing in Indian Railways



occupies a unique position, as it is carried out concurrently in a systemic manner.

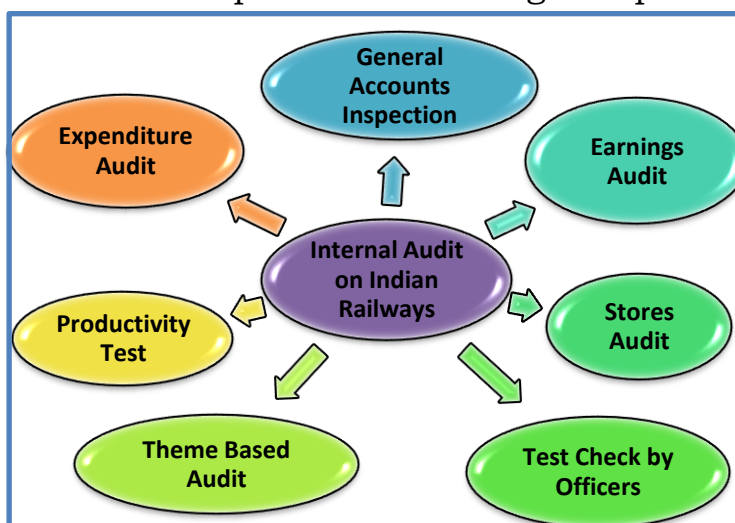
However, in view of the growing size of activities, fast changing socio-economic scenario and attendant attitudes, processes and systems, it needs to be reviewed and revamped. Growing complexities and lack of training are few of the challenges faced by the Internal Auditors. Internal Audit process is no longer just a mechanical lower level work but has evolved into a niche area within the management, requiring special skills and training.

3.1 Internal Audit in Indian Railways

Indian Railways comprises of three level of hierarchal system for the purpose of Internal Audit. At the top level is the Railway Board which is mainly responsible for planning and policy making; at the middle level are the Zonal Railways/ Production Units which govern and coordinate various railway activities and at the lowest level are the Division/Workshops/ Construction Units which are responsible for actual operation and maintenance of all railway activities.

The process of internal audit is conducted through concurrent internal check exercised by the Internal Auditors or the staff and officers of the Railways' Accounts Department and regular periodic inspections exercised by the staff/officers of the Accounts and concerned executive department.

The internal check is carried out in adherence to various Accounts and Finance Codes and Manuals and in compliance to



Codes and Manuals issued by various Departments of Indian Railways. Similarly, inspections are carried out in a systematic manner in compliance to laid-down rules, procedures and systems prescribed in these Codes and Manuals and highlight the deviations, if any. A list of various Railway Codes and Manuals are placed as **Appendix**.

While the results of concurrent checks are shared with the concerned departments on a regular basis, inspection reports are issued and forwarded to concerned department for their remarks and correction action, as required. Based on the reply and corrective action taken, the paragraphs of the inspection report are closed.

3.2 Internal Check: Internal check or internal audit carried on Indian Railways is concurrent and is exercised by Accounts Officer on all the financial transactions of the railway on behalf of the Railway Administration. The internal check is conducted with reference to Rules and orders issued by the President, the Railway Board, General Managers of Railways and other subordinate authorities to whom the power to issue rules or orders has been delegated; the instructions contained in various Indian Railway Codes/Manuals; any further instructions issued from time to time by the Railway Board; and the recognised standards of financial propriety, which mainly state that:

- 1) The expenditure should not prima facie be more than the occasion demands;
- 2) That every Government servant should exercise the same vigilance in respect of expenditure incurred from public moneys as a person of ordinary prudence would exercise in respect of the expenditure of his own money;
- 3) That no authority should exercise its powers of sanctioning expenditure to pass an order which will be directly or indirectly to its own advantage;
- 4) Public moneys should not be utilized for the benefit of a particular person or section of the community unless-
 - i. The amount of expenditure involved is insignificant; or
 - ii. A claim for the amount could be enforced in a Court of law; or
 - iii. The expenditure is in pursuance of a recognised policy or custom.
- 5) That the allowances, such as travelling allowances, granted to meet expenditure of a particular type, should be so regulated that the allowances are not on the whole sources of profit to the recipients.

The Indian Railways Code for the Accounts Department (Part-I) lay down specific provisions of internal check for various activities carried out in Indian Railways. Relevant paragraphs of the Code for Internal Check of a few main activities are detailed below:

3.2.1 Internal check of Sanctions (Para 804)

All sanctions and orders involving financial considerations affecting railway receipts, expenditure and establishment charges, issued by the Railway Board or higher authorities are examined to ascertain whether the authority framing the rule or according the sanctions is competent to do so; the sanction is definite; the rule or order or sanction does not contravene any general or special orders of any higher authority, and that in all orders conveying sanctions to expenditure of definite amounts or up to specified limits are expressed both in words and figures. Utmost care and attention is devoted to internal check of sanctions to expenditure.

3.2.2 Internal check of Expenditure

In terms para 804 of Accounts Code, Part-I, all expenditure is subjected to internal audit, either as a Pre-check or a Post-check. All claims are pre-checked unless it is likely to lead to any delay in cases of exigencies or violate any of the provisions of the extant statutes (e.g. Payment of Wages Act), or stated otherwise or when a system of post-check is found necessary in order to secure an even distribution of work throughout the month either in the bill preparing offices or in the bill checking offices. However, all bills of expenditure under the post-check system, on receipt from the Cashier, are subjected to all the internal checks prescribed in the Codes/Manuals, for any irregularities, which is brought to the notice at the appropriate level. All claims for payments are thus scrutinized, inter alia, to see that:

- i. the expenditure is incurred by an officer competent to incur it;
- ii. the remission of revenue has been sanctioned by competent authority;
- iii. all prescribed preliminaries to expenditure have been observed;
- iv. it is covered by the grant at the disposal of the officer incurring it or by funds re-appropriated by competent authority for the purpose;

- v. the expenditure does not contravene any rules and orders in force, or any general or special orders issued by competent authority;
- vi. the expenditure does not involve a breach of the canons of financial propriety;
- vii. the expenditure sanctioned for a limited period is not admitted beyond that period without further sanction;
- viii. in the case of recurring charges which are payable on the fulfillment of certain conditions or till the occurrence of a certain event, a certificate is forthcoming from the drawing officer to the effect that the necessary conditions have been fulfilled or the event has not yet occurred;
- ix. the expenditure has been properly and fully vouched for and that payment has been so recorded as to render a second claim on the same account impossible;
- x. the charge has been correctly classified and that if a charge is debitabale to the personal account of a contractor, employee or other individual or is recoverable from him under any rule or order, it is recorded as such in a prescribed account.

3.2.3. Internal check of Debt and Remittance Transactions

As per para 820 of Accounts code, Part-II, the general principles and rules of internal check which govern check of expenditure apply mutatis mutandis to disbursement, under Debt and remittance heads. In the case of repayment, the payment is checked against the original receipt, rules, regulations or orders which govern the transactions. Similarly, in case of a payment which is to be subsequently recovered, the payments are checked in accordance with the extant rules and regulations and a regular watch is kept to ensure that the moneys are regularly recovered from the debtor.

3.2.4 Internal check of Workshop Accounts

The internal check of Workshop accounts includes, inter alia, an examination of cost accounts maintained, in order to see that they are

correctly compiled. Any discrepancies between the aggregate of the expenditure charged to various jobs and the figures in the expenditure account are investigated.

3.2.5 Internal Check of Stores Transactions

Similarly the Accounts Department conducts internal check of stores transactions in the office, in compliance to Indian Railways Code for the Accounts Department Part I and the Indian Railways Code for the Stores Department Volume I and II. However, there is a need to do physical verification of stores at the depot where the stores are stacked. This work is done by a cadre of officials known as Inspector of Stores Accounts (ISA). These officials visit the stock depots and verify the physical availability of the stores with respect to book balance and difference between the two is reported through inspection reports called Stock Sheets. After investigation of the issues raised in the Stock Sheets, necessary actions are taken by the Stores department which may entail recovery from the staff wherever due.

3.2.6 Internal Check of Catering Accounts

The Departmental Catering on Railways is required to run on a 'No Profit No Loss' basis. A proforma Profit and Loss Account is prepared for each unit after taking into account the receipts from Sales and all direct and indirect expenses in running the Departmental catering units. The Accounts Check of Profit and Loss Account of each unit will cover not only the usual check of receipts and payments but also correct preparation of the proforma of Profit and Loss Accounts.

3.2.7. Internal Check of Earnings

Internal checks and test checks of earnings are exercised in the Accounts Office in compliance to Indian Railways Code for the Accounts Department Part II and Indian Railways Code for Traffic (Commercial) Department. The check is conducted both at the station by the Travelling Inspector of Accounts (TIAs) and the Accounts Office on the basis of returns and documents submitted by stations at definite intervals. The internal checks in Accounts Office are supplemented by regular, vigilant and effective outdoor checks of the

initial records and documents which are kept at stations and not available to the Accounts Office during Internal Checks by the Travelling Inspector of Accounts (TIAs). Their primary duty is to ensure that the income on account of the services rendered by the Railways and related documents are properly and correctly accounted for and remitted by Stations.

3.3 Productivity Tests

In the case of works which have been sanctioned primarily based on positive rate of return, productivity test/review is required to be conducted by the Accounts Department. The object of the Productivity Test is to compare the earnings or savings in working expenses which are getting realized after the completion and commencement of commercial operations of the project and comparison of the same with anticipated earnings used for the calculation of the financial return when the proposal was sanctioned.

3.4 SWOT Analysis of Present System of Internal Audit

Strength •Concurrent process of Internal Audit/Check •Well codified systems. •Robust reporting system. •Transaction based compliance. •Strong manpower of Auditors. •Wide spectrum of Audited areas. •Organisational Acceptance.	Opportunity •Reorient internal audit. •Strengthen governance processes. •Focus on evaluation of controls •Risk based internal Audit. •Stakeholders Assurance. •Improve effective controls systems. •System improvements.
Weakness •Mostly test Checks. •Does not focus on risk areas •Does not provide consultancy to higher management for effective decision making.	Threats •Not kept pace with requisite skills. •Non-involvement of higher management. •Non-induction of new systems. •Lack of ungraded skills. •Lack of IT environment

As brought out above, a robust system of Internal Audit does exist on IR. Traditionally, the focus of internal audit has been on compliance and Financial Audit involving compliance with rules, regulations, policies and procedures.

Internal Auditors are now expected to focus on Performance Audit involving evaluation of controls, risks to the business and provide an assurance to the Management that the controls are properly functioning.

This calls for a SWOT Analysis of the existing Internal Audit systems on Indian Railways.

The analysis shows that there is scope for reorienting the Internal Audit functions and make it more relevant to the organization.

3.5 Recent Initiatives

With a view to reorient the Internal Audit function, Ministry of Railways have recently issued instructions regarding strengthening of the Internal Audit Cell in Accounts Department of each Zonal Railway.

Each Zone and Production Unit is expected to conduct theme based audits each year. Detailed guidelines regarding the procedure to be followed for these “Theme-Based Audits” has been issued, which, inter-alia include identification of the theme by the Head of the Accounts Department and the finalisation of the study in

20.10.2015-	GMs advised to undertake Theme based IA. All units to prepare two reports.
11.12.2015-	Formation of inter disciplinary IA Teams.
8.12.2015 -	Scheme of IA of IR endorsed by Indian Railway Advisory Board (MR, Chairman SBI, Chairman IFDC and RB members).
23.1.2015	Action Plan of 2016-17 for IA finalized.
29.1.2015	SECR submits the first IA report to RB.
22.2.2016	Training of Internal Auditors at NIFM.
31.3.2016	Finalization of IA topics for 2016-17.
31.4.2016	Publication of the first ever consolidated report of Internal Audit of Indian

consultation with the concerned Head of the Department which is being audited under the supervision of the General Manager. Strict timelines have been drawn for various milestones and the same are monitored at the Railway Board level. This initiative involves the

management at the highest levels and is thus expected to give the desired outcomes.

It has also been decided to impart training to the internal audit teams to upgrade their skill sets and bring about an improvement in the nuances of the conceptual understanding, quantitative techniques and by introduction of cutting edge analytical IT tools. The training is expected to make this activity more professional and provide an effective consultancy function to the internal audit. The first batch will start its training soon.

3.6 Road Ahead

The work environment on Indian Railways is undergoing shift as many activities which hitherto were being done manually are now being done with the use of Information Technology. Accounting Reforms are underway. Active efforts are being made to shift towards accrual accounting and funds for CAPEX are now being arranged through Institutional Finance. All these changes warrant a fresh look at the extant Internal Audit systems and to evaluate the attendant risks involved.

To achieve the new objectives of Internal Audit in the charged environment, action will have to be taken to strengthen Internal Audit mechanism which would require, inter-alia, capacity building, partnering with Professional Bodies, putting in place a more robust monitoring and reporting system and improved accountability.

3.7 Internal Audit discussion in Advisory Board

A meeting of the Advisory Board on Railway Finance was held on 8.12.2015. The meeting was also attended by Railway Board Members and chaired by Hon'ble MR. One of the agenda items of the meeting was Internal Audit on Indian Railways.

A presentation on Internal Audit was made to the Board and various issues were discussed. Relevant extracts of the Advisory Board meeting pertaining to Internal Audit are given below:

The Minister for Railways said that the logic of a robust Internal Audit should be to facilitate internal control and we need to upgrade auditing to a level where it helps to track government expenditure to output.

Smt. Arundhati Bhattacharya, Chairman SBI (member of the Advisory Board) mentioned that SBI has a very robust audit system..... Auditing has become more centralized with web-based data available from the central system and less and less auditing is carried out on-site to avoid disturbance to operating units..... There is a set frequency of auditing at different levels based on audit rating. Self-auditing prior to commencement of Audit is important which leads to better preparation and brings down pressure.

Dr. Rajiv Lall, MD and CEO of IDFC Bank (member of Advisory Board) opined that the design of data analytics architecture should take into account audit requirements.....The best talent should, therefore, be engaged for designing the architecture for data analytics which should be time-proof ”.

3.8 Recent Developments in Internal Audit on Indian Railways

Internal Audit has caught the attention of the Railway Ministry at the highest level as is evident from the recent communications from Hon’ble MR and FC (Rlys.) on this topic. FC (Rlys) vide his letter dated 20.10.2015 (page 23) initiated the process of Internal Audit on Indian Railways and issued detailed guidelines. Subsequently, in his message (page 24) published in the Compendium of Internal Audit Reports, Hon’ble MR highlighted the need to take corrective action based upon the Internal Audit reports published in the compendium. FC (Rlys) while forwarding the compendium to Railways urged them to replicate the studies in their Railways (page 25).

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**Letter written by FC (Railways) initiating the process of Internal Audit Reports in Indian Railways**

संजय मुखर्जी  
S. Mookerjee



वित्तियुक्त (रेलवे) एवं वंदेन सचिव  
भारत सरकार, रेल मंत्रालय  
एवं  
अध्यक्ष, इंडियन रेलवे फाइनेंस कॉर्पोरेशन लि.  
FINANCIAL COMMISSIONER (RAILWAYS)  
AND EX. OFFICIO SECRETARY TO GOVT. OF INDIA  
&  
CHAIRMAN, INDIAN RAILWAY FINANCE CORPORATION LTD.  
MINISTRY OF RAILWAYS  
RAIL BHAWAN, NEW DELHI - 110001  
PHONE : (+) 91-11-23382754 / (+) 91-11-23385095 (FAX)  
RBA No. 66/2015

No. 2015/AC-II/20/16

New, Delhi, Dated 20.10.2015

General Managers,  
All Zonal Railways and Production Units.

Sub: Strengthening of Internal Audit System.

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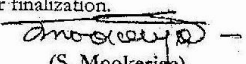
At present our Internal Audit system is confined to inspections of Executive Offices, Stations, Stores Depots, Divisional Sub-divisional Offices by Accounts Officers. The object thereof predominantly is to see that the bills, returns, vouchers etc, submitted to the Accounts office by these offices have been correctly prepared and accord with facts and that all such initial records on which bills, returns, vouchers etc. are based have been maintained efficiently besides ensuring that financial rules and orders are being carried out, and that the executive authorities responsible for keeping the accounts, exercise due care over the accuracy of the accounts.

Over the time these inspections have become routine in nature and are not contributing to major system improvements. It is desirable to bring about structural improvement in the present system of internal audit. In view of the above, it is decided that apart from the present system of internal audit described above, the **Internal Audit Cells** of Accounts Department on Railways, which were formed on Railways in mid-nineties, to carry out system improvement studies should be revived.

FA&CAO of each Railway and Production Unit shall select two subject areas for special studies during each year. Executive Director Finance Commercial in Railway Board shall coordinate and monitor functioning of these cells on Railways. These cells will carry out "Theme Based System Audits". The process involved would be as under:

- 1) Identification of subject by FA&CAOs on Zonal Railways/ Production Units,
- 2) Holding of an Entry Conference by FA&CAO with PHODs concerned in presence of General Manager,
- 3) Nomination of nodal officer in each department to facilitate system audit,
- 4) Compilation of Internal Audit Report in consultation with Department concerned,
- 5) Holding of an Exit Conference on the draft report by FA&CAO with PHODs concerned in presence of General Manager,
- 6) Finalization of Internal Audit Report,
- 7) Submission of Final report to PHOD concerned for submission of Action Taken Report thereon to General Managers through FA&CAO, alongwith copy to Railway Board.
- 8) Finalisation of Action Taken Report within 90 days of preparation of Final Internal Audit Report

The salient features of the Internal Audit Report will be shared with all the railways for information and system improvement. For 2015-16, FA&CAOs may select subjects under advise to EDFC by 02.11.2015 and finalize reports by 31.01.2016. A copy of Action Taken Report may also be sent to Board after finalization.

  
(S. Mookerjee)  
Financial Commissioner (Railways)  
Railway Board

Copy for information and necessary action to FA&CAOs/Zonal Railways and Production Units.

## *Manual For Internal Audit on India Railways*

**Message of Hon'ble MR published in the Compendium of Internal Audit Reports of**

**2015-16**

सुरेश प्रभु  
SURESH PRABHU



रेल मंत्री  
भारत सरकार, नई दिल्ली  
MINISTER OF RAILWAYS  
GOVERNMENT OF INDIA  
NEW DELHI



### MESSAGE

I am happy to see the first ever publication of the "**Compendium of Theme Based Internal Audit Reports of Indian Railways, 2015-16**" compiled by Railway Board on the studies conducted in 2015-16 by Zonal Railways, Production units, COFMOW, RDSO and CORE. I wish to congratulate all those who were associated with these studies and the publication of this Compendium.

Internal Audit is an important managerial tool which alerts the management about system failures, revenue leakages, infructuous expenditure and other aspects which impact the revenue potential and efficient working of any organization.

Logically, the next step is to take corrective steps to overcome the shortcomings highlighted in the reports and implement the suggestions after their quick evaluation. I would urge upon the Railway Board and General Managers to take necessary action in this regard within fixed timelines. These studies may be replicated in all Zones and units so that benefits accrue to all.

I look forward to see a similar compendium of the theme based Internal Audit studies at the end of each year.

  
**Suresh Prabhu**  
Minister for Railways

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239, Ministry of Railways, Rail Bhawan, New Delhi-110001  
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sureshprabhu@rb.railnet.gov.in, sureshprabhu@gov.in

**Letter written by FC (Railways) to GMs while forwarding the Compendium of Internal Audit Reports of Indian Railway 2015-16**

GOVERNMENT OF INDIA  
MINISTRY OF RAILWAYS  
(RAILWAYS BOARD)

No.2015/A/Cs Insp/IA/Master File

Date: 12.07.2016

My Dear *General Manager*

(All Zonal Railways, Production Units, CORE, DG/RDSO & CAO/COFMOW)

**Sub: Compendium of Internal Audit Reports of Indian Railways for 2015-16**

You may please connect my letter No.2015/AC-II/20/16 dt. 20.10.2015 through which guidelines were issued regarding formation of Internal Audit Cells in the Railways and of conducting two theme-based system audits by each Railway. It was also informed that the salient features of the Internal Audit Reports will be shared with all the Railways for system improvement.

I am happy to inform that the theme-based system audits were completed by various Units within the target date of 31.3.2016. These Internal Audit Reports were thereafter examined in Board and 34 summarized reports have been compiled and published in the Compendium of Internal Audit Reports of Indian Railways for 2015-16. I am enclosing two copies of this Compendium for your kind perusal and further necessary action. Separate copies are being sent to the PHODs of your Railway.

To leverage the insights gained by various Railways through the audit conducted by them, I would request you to please get all the studies included in the Compendium replicated on your Railway also through the concerned PHODs. You may like to nominate the AGM of your Railway to monitor this exercise. This exercise may be completed by 31.12.2016 and a compliance report sent to Board along with a summary of the outcomes achieved for each theme based audit report.

I take this opportunity to also request you to forward the theme based system audit report of your Railway for the year 2016-17 (mentioned below) to Railway Board by 31.7.2016.

-sd-

(S. Mookerjee)  
Financial Commissioner (Railways)  
Railway Board

## **Chapter-4**

### **STANDARDS OF INTERNAL AUDIT ISSUED BY ICAI**

There are 18 Standards on Internal Audit (SIA) compiled in the “Compendium of Standards on Internal Audit” by the Institute of Chartered Accountants of India issued on July 1, 2013 which are as follows:

There are 18 Standards on Internal Audit compiled in the “Compendium of Standards on Internal Audit” by the Institute of Chartered Accountants of India as on July 1, 2013.

- **Standard on Internal Audit (SIA) 1**  
Planning an Internal Audit
- **Standard on Internal Audit (SIA) 2**  
Basic Principles Governing Internal Audit
- **Standard on Internal Audit (SIA) 3**  
Documentation
- **Standard on Internal Audit (SIA) 4**  
Reporting
- **Standard on Internal Audit (SIA) 5**  
Sampling
- **Standard on Internal Audit (SIA) 6**  
Analytical Procedures
- **Standard on Internal Audit (SIA) 7**  
Quality Assurance in Internal Audit
- **Standard on Internal Audit (SIA) 8**  
Terms of Internal Audit Engagement
- **Standard on Internal Audit (SIA) 9**  
Communication with management
- **Standard on Internal Audit (SIA) 10**  
Internal Audit Evidence
- **Standard on Internal Audit (SIA) 11**  
Consideration of Fraud in an Internal Audit
- **Standard on Internal Audit (SIA) 12**  
Internal Control Evaluation
- **Standard on Internal Audit (SIA) 13**

Enterprise Risk Management

- **Standard on Internal Audit (SIA) 14**  
Internal Audit in an Information Technology Environment
- **Standard on Internal Audit (SIA) 15**  
Knowledge of the Entity and its Environment
- **Standard on Internal Audit (SIA) 16**  
Using the Work of an Expert
- **Standard on Internal Audit (SIA) 17**  
Consideration of Laws and Regulations in an Internal Audit
- **Standard on Internal Audit (SIA) 18**  
Related Parties

These standards lay down as guiding principles to the Internal audit teams in discharge of their duties efficiently and effectively. Five (1,2,3,5 and 13) Standards of Internal Audit relevant to the Railways are detailed below.

#### **4.1 SIA-1 Planning the Internal Audit**

1. The purpose of this Standard on Internal Audit is to establish standards and provide guidance in respect of planning an internal audit. An internal audit plan is a document defining the scope, coverage and resources, including time required for an internal audit over a defined period. The Internal Auditor should, in consultation with those charged with governance, including the audit committee, develop and document a plan for each internal audit engagement to help him conduct the engagement in an efficient and timely manner. Adequate planning ensures that appropriate attention is devoted to significant areas of audit, potential problems are identified, and that the skills and time of staff are appropriately utilized. Planning also ensures that the work is carried out in accordance with the applicable pronouncements of the Institute of Chartered Accounts of India.

2. The overall objectives of an internal audit, as defined in the Preface to Standard on Internal Audit are :

- i. To suggest improvements to the functioning of the entity; and
- ii. To strengthen the overall governance mechanism of the entity, including its strategic risk management as well as internal control system.

3. Internal Audit , therefore, helps inter alia in :

- i. Understanding and assessing the risks and evaluate the adequacies of the prevalent internal controls.
- ii. Identifying areas for systems improvement and strengthening controls.
- iii. Ensuring optimum utilisation of the resources of the entity, for example, human resources, physical resources etc.
- iv. Ensuring proper and timely identification of liabilities, including contingent liabilities of the entity.
- v. Ensuring compliance with internal and external guidelines and policies of the entity as well as the applicable statutory and regulatory requirements.
- vi. Safeguarding the assets of the entity.
- vii. Reviewing and ensuring adequacy of information systems security and control.
- viii. Reviewing and ensuring adequacy, relevance, reliability and the timelessness of management systems.

4. The internal audit plan should be comprehensive enough to ensure that it helps in achieving of the above overall objectives of an internal audit. The internal audit plan should, generally, also be consistent with the goals and objectives of the internal audit function as listed out in the internal audit charter as well as the goals and objectives of the organization. An internal audit charter also outlines the scope of internal audit as well as the duties, responsibilities and powers of internal auditor(s). In case the entire internal audit or a particular internal audit engagement has been outsourced, the internal auditor should

also ensure that the plan is consistent with the terms of the engagement.

5. Planning involves developing an overall plan for the expected scope and conduct of audit and developing an audit programme showing the nature, timing and extent of audit procedures. Planning is a continuous exercise. A plan once prepared should be continuously reviewed by the internal auditor to identify any notifications required to bring the same in line with the changes, if any in the audit environment. However, any major modification to the internal audit plan should be done in consultation with those charged with governance. Further, the internal auditor should also document the changes to the internal audit plan.
6. The internal auditor also has a continuing responsibility to maintain professional knowledge and skills at a level required to ensure that the client or the employer receives the advantages of competent professional service based on the latest developments in the profession, the economy, the relevant industry and legislation.

#### **4.2 SIA-2 - BASIC PRINCIPLES GOVERNING INTERNAL AUDIT**

The purpose of this Standard on Internal Audit (SIA) is to establish standards and provide guidance on the general principles governing internal audit.

Paragraph 3.1 of the Preface to the Standards on Internal Audit, issued by the Institute of Chartered Accountants of India defines internal audit as follows: “Internal audit is an independent management function, which involves a continuous and critical appraisal of the functioning of an entity with a view to suggest improvements thereto and add value to and strengthen the overall governance mechanism of the entity, including the entity’s risk management and internal control system.”

The internal auditor should be straightforward, honest and sincere in his approach to his professional work. He must be fair and must not allow prejudice or bias to override his objectivity. He should maintain an impartial attitude. He should not only be independent in fact but also appear to be independent. The internal auditor should not, therefore, to the extent possible, undertake activities, which are or might appear to be incompatible with his independence and objectivity. For example, to avoid any conflict of interest, the internal auditor should not review an activity for which he was previously responsible. It is also expected from the management to take steps necessary for providing an environment conducive to enable the internal auditor to discharge his responsibilities independently and also report his findings without any management interference.

The internal auditor should immediately bring any actual or apparent conflict of interest to the attention of the appropriate level of management so that necessary corrective action may be taken.

The internal auditor should maintain the confidentiality of the information acquired in the course of his work and should not disclose any such information to a third party, including the employees of the entity, without the specific authority of the management/ client or unless there is a legal or a professional responsibility to do so. The internal auditor, therefore, needs to ensure that there are well laid out policies and controls to protect confidentiality of the information.

The internal auditor should exercise due professional care, competence and diligence expected of him while carrying out the internal audit. Due professional care signifies that the internal auditor exercises reasonable care in carrying out the work entrusted to him in terms of deciding on aspects such as the extent of work required to achieve the objectives of the engagement, relative complexity and materiality of the matters subjected to internal audit, assessment of risk management, control and governance processes and cost benefit analysis. Due professional care, however, neither implies nor

guarantees infallibility, nor does it require the internal auditor to travel beyond the scope of his engagement.

The internal auditor should either have or obtain such skills and competence, acquired through general education, technical knowledge obtained through study and formal courses, as are necessary for the purpose of discharging his responsibilities.

The internal auditor also has a continuing responsibility to maintain professional knowledge and skills at a level required to ensure that the client or the employer receives the advantage of competent professional service based on the latest developments in the profession, the economy, the relevant industry and legislation.

#### **4.3 SIA 3. DOCUMENTATION**

Internal audit documentation may be recorded on paper or on electronic or other media. It includes, for example, audit programmes, analyses, issues memoranda, summaries of significant matters, letters of confirmation and representation, checklists, and correspondence (including e-mail) concerning significant matters. Abstracts or copies of the entity's records, for example, significant and specific contracts and agreements, may be included as part of internal audit documentation, if considered appropriate. The internal audit documentation for a specific internal audit engagement is assembled in an audit file.

Internal audit documentation should record the internal audit charter, the internal audit plan, the nature, timing and extent of audit procedures performed, and the conclusions drawn from the evidence obtained.

Internal audit documentation should be designed and properly organised to meet the requirements and circumstances of each audit and the internal auditor's needs in respect thereof. The internal auditor should formulate policies that help in standardization of the

internal audit documentation. The standardization may be in the form of checklists, specimen letters, questionnaires, etc.

Internal audit documentation should be sufficiently complete and detailed for an internal auditor to obtain an overall understanding of the audit. The extent of documentation is a matter of professional judgment since it is neither practical nor possible to document every observation, finding or conclusion in the internal audit documentation. All the significant matters which require exercise of judgment, together with the internal auditor's conclusion thereon should be included in the internal audit documentation. However, the documentation prepared by the internal auditor should be such that enables an experienced internal auditor (or a reviewer), having no previous connection with the internal audit to understand:

- (a) the results of the audit procedures and the audit evidence obtained;
- (b) significant matters arising during the audit and the conclusions reached thereon; and scope of work, reporting requirements, any other special conditions, affecting the internal audit.

The form, content and extent of internal audit documentation depend on factors such as: the nature and extent of the audit procedures to be performed; the identified risks of material misstatement; the extent of judgment required in performing the work and evaluating the results; the significance of the audit evidence obtained; the nature and extent of exceptions identified; the need to document a conclusion or the basis for a conclusion not readily determinable from the documentation of the work performed or audit evidence obtained; and the audit methodology and tools used. It is, however, neither necessary nor practicable to document every matter the auditor considers during the audit.

The internal audit documentation should cover all the important aspects of an engagement viz., engagement acceptance, engagement planning, risk assessment and assessment of internal controls,

evidence obtained and examination/ evaluation carried out, review of the findings, communication and reporting and follow up. The internal audit documentation would, therefore, generally, include:

- Engagement letter or the internal audit charter, as the case may be.
- Internal audit plan and programme.
- Papers relating to the staff requirement and allocation.
- Papers relating to requirements for technical experts, if any.
- Time and cost budgets.
- Copies of significant contracts and agreements or management representations on terms and conditions of those contracts.
- Internal review reports. Evaluation questionnaires, checklists, flowcharts, etc.
- Papers relating to discussions/ interviews with the various personnel including legal experts, etc.
- Chart of the organizational structure, job profile of the persons listed in the chart and rules of delegation of powers.
- Annual budget and development plan.
- Progress report, MIS report.
- Reconciliation statements.
- Communication with the client personnel and third parties, if any.
- Certification and representations obtained from management.
- Copies of relevant circulars, extracts of legal provisions.
- Results of risk and internal control assessments.

- Analytical procedures performed and results thereof.
- List of queries and resolution thereof. Copy of draft audit report, along with the comments of the auditee thereon and final report issued.
- Records as to the follow up on the recommendations/ findings contained in the report.

#### **4.4 SIA 5 SAMPLING**

**"Audit sampling"** means the application of audit procedures to less than 100% of the items within an account balance or class of transactions to enable the internal auditor to obtain and evaluate audit evidence about some characteristic of the items selected in order to form a conclusion concerning the population.

Certain testing procedures, however, do not come within the definition of sampling. Tests performed on 100% of the items within a population do not involve sampling. Likewise, applying internal audit procedures to all items within a population which have a particular characteristic (for example, all items over a certain amount) does not qualify as audit sampling with respect to the portion of the population examined, nor with regard to the population as a whole, since the items were not selected from the total population on a basis that was expected to be representative. Such items might imply some characteristic of the remaining portion of the population but would not necessarily be the basis for a valid conclusion about the remaining portion of the population.

**"Population"** means the entire set of data from which the sample is selected and about which the internal auditor wishes to draw conclusions. A population may be divided into various strata, or subpopulations, with each stratum being examined separately. When designing an audit sample, the internal auditor should consider the

specific audit objectives, the population from which the internal auditor wishes to sample, and the sample size.

**“Sampling risk”** means the risk that emanates from the possibility that the internal auditor’s conclusions, based on examination of a sample may be different from the conclusion reached if the entire population was subjected to the same types of internal audit procedure. The two types of sampling risk are:

- 1) The risk that the internal auditor concludes, in the case of tests of controls (TOC), that controls are more effective than they actually are, or in the case of tests of details (TOD), that a material error or misstatement does not exist when in fact it does.

**“Sampling unit”** means the individual items or units constituting a population, for example, credit entries in bank statements, sales invoices or debtors’ balances.

**“Statistical sampling”** means any approach to sampling procedure which has the following characteristics –

- 1) Random selection of a sample; and
- 2) Use of theory of probability to evaluate sample results, including measurement of sampling risk.

**Stratification** - To assist in the efficient and effective design of the sample, stratification may be appropriate. Stratification is the process of dividing a population into sub-populations, each of which is a group of sampling units, which have similar characteristics (often monetary value). The strata need to be explicitly defined so that each sampling unit can belong to only one stratum. This process reduces the variability of the items within each stratum. Stratification, therefore, enables the internal auditor to direct audit efforts towards the items which, for example, contain the greatest potential monetary error. For example, the internal auditor may direct attention to larger value items for accounts receivable to detect overstated material

misstatements. In addition, stratification may result in a smaller sample size.

**Sample Size** - When determining the sample size, the internal auditor should consider sampling risk, the tolerable error, and the expected error. The lower the risk that the internal auditor is willing to accept the greater the sample size needs to be.

The sample size can be determined by the application of a statistically based formula or through exercise of professional judgment applied objectively to the circumstances of the particular internal audit engagement.

**Selection of the Sample** - The internal auditor should select sample items in such a way that the sample can be expected to be representative of the population. This requires that all items or sampling units in the population have an opportunity of being selected.

### **Methods of Sample Selection**

The principal methods of sample selection are:

1. **Computerised random selection** - Using a computerised random number generator or through random number tables.
2. **Systematic selection** - In this method, the number of sampling units in the population is divided by the sample size to give a sampling interval. For example, determining a starting point within the first 20, each 20th sampling unit thereafter is selected. Although the starting point may be haphazardly determined, the sample is likely to be truly random if the same is determined by using a computerised random number generator or random number tables. In this method, the internal auditor would need to determine that sampling units within the population are not structured in such a way that the sampling

interval corresponds with any particular pattern within the population.

3. **Haphazard selection** – In this method, the internal auditor selects the sample without following any structured technique. The internal auditor should attempt to ensure that all items within the population have a chance of selection, without having any conscious bias or predictability. This method is not appropriate when using statistical sampling technique.
4. **Block selection** – This method involves selection of a block(s) of adjacent or contiguous items from within the population. Block selection normally cannot be used in internal audit sampling because most populations are structured in such a manner that items forming a sequence can be expected to have similar characteristics to each other, but different characteristics from items elsewhere in the population. This method would not be an appropriate sample selection technique when the internal auditor intends to draw valid inferences about the entire population, based on the sample.

#### **4.5 SIA 13. ENTERPRISE RISK MANAGEMENT**

The purpose of this Standard on Internal Audit is to establish standards and provide guidance on review of an entity's risk management system during an internal audit or such other review exercise with the objective of providing an assurance thereon.

This Standard applies where the internal auditor has been requested by the management to provide such an assurance on the effectiveness of its enterprise risk management system.

Enterprise risk management enables management to effectively deal with risk, associated uncertainty and enhancing the capacity to build value to the entity or enterprise and its stakeholders. Internal auditor

may review each of these activities and focus on the processes used by management to report and monitor the risks identified.

### **Risk and Enterprise Risk Management**

Risk is an event which can prevent, hinder, fail to further or otherwise obstruct the enterprise in achieving its objectives. A business risk is the threat that an event or action will adversely affect an enterprise's ability to maximize stakeholder value and to achieve its business objectives. Risk can cause financial disadvantage, for example, additional costs or loss of funds or assets. It can result in damage, loss of value and /or loss of an opportunity to enhance the enterprise operations or activities. Risk is the product of probability of occurrence of an event and the financial impact of such occurrence to an enterprise.

### **Risk Classification**

**Strategic Risks** are associated with the primary long-term purpose, objectives and direction of the business.

**Operational Risks** are associated with the on-going, day-to-day operations of the enterprise.

**Financial Risks** are related specifically to the processes, techniques and instruments utilised to manage the finances of the enterprise, as well as those processes involved in sustaining effective financial relationships with customers and third parties.

**Knowledge Risks** are associated with the management and protection of knowledge and information within the enterprise.

### **Process of Enterprise Risk Management and Internal audit**

Enterprise Risk Management is a structured, consistent and continuous process of measuring or assessing risk and developing strategies to manage risk within the risk appetite. It involves identification, assessment, mitigation, planning and implementation of risk and developing an appropriate risk response policy. Management

is responsible for establishing and operating the risk management framework.

The Enterprise Risk Management process consists of Risk identification, prioritization and reporting, Risk mitigation, Risk monitoring and assurance. Internal audit is a key part of the lifecycle of risk management. The corporate risk function establishes the policies and procedures, and the assurance phase is accomplished by internal audit.

### **Role of the Internal Auditor in Relation to Enterprise Risk Management**

The role of the internal auditor in relation to Enterprise Risk Management is to provide assurance to management on the effectiveness of risk management. Due consideration should be given to ensure that the internal auditor protects his independence and objectivity of the assurance provided. The role of the internal auditor is to ascertain that risks are appropriately defined and managed.

The scope of the internal auditor's work in assessing the effectiveness of the enterprise risk management would, normally, include:

- 1) assessing the risk maturity level both at the entity level as well as auditable unit level;
- 2) assessing the adequacy of and compliance with the risk management policy and framework; and
- 3) for the risks covered by the internal audit plan:
  - a. Assessing the efficiency and effectiveness of the risk response; and
  - b. Assessing whether the score of the residual risk is within the risk appetite.

The nature of internal auditor's responsibilities should be adequately documented and approved by those charged with governance. The

internal auditor should not manage any of the risks on behalf of the management or take risk management decisions. The internal auditor should not assume any accountability for risk management decisions taken by the management. Internal auditor has a role only in commenting and advising on risk management and assisting in the effective mitigation of risk.

The internal auditor has to review the structure, effectiveness and maturity of an enterprise risk management system. In doing so, he should consider whether the enterprise has developed a risk management policy setting out roles and responsibilities and framing a risk management activity calendar. The internal auditor should review the maturity of an enterprise risk management structure by considering whether the framework so developed, inter alia:

- 1) protects the enterprise against surprises;
- 2) stabilizes overall performance with less volatile earnings;
- 3) operates within established risk appetite;
- 4) protects ability of the enterprise to attend to its core business;
- 5) creates a system to proactively manage risks.

The risk review process to be carried out by the internal auditor provides the assurance that there are appropriate controls in place for the risk management activities and that the procedures are understood and followed. Effective enterprise risk management requires a monitoring structure to ensure that the risks are effectively identified and assessed and that the appropriate mitigation plans are in place. The review process conducted by internal auditors will help to determine, inter alia:

- 1) whether the adopted measures result in what was intended;
- 2) whether the procedures adopted and information gathered for undertaking the assessment were appropriate; and

- 3) further, improved knowledge would help in reaching better decisions and identifying the lessons to improve future assessment and management of risks.

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DRAFTING THE INTERNAL AUDIT REPORT

5.1 Some Do's and Don'ts

**Some personal but pertinent insights by Richard Chambers,
(CIA), (CGAP), (CCSA)**

1. Don't say, "Management should consider..."

Audit reports should offer solid recommendations for specific actions. When our recommendation is merely to "consider" something, even the most urgent call to action can become nebulous. No auditor wants a management response that says merely, "Okay, we'll consider it."

2. Don't use "weasel words."

It's tempting to hedge our words with phrases such as "it seems that" or "our impression is" or "there appears to be." It may feel safer to avoid being specific, but when you have too many hedges, particularly in the same sentence, there's a danger that you are not presenting well-supported facts. Report readers need to know they can rely on our facts, and over-use of weasel words can make solid recommendations sound a little too much like hunches.

3. Use "intensifiers" sparingly.

Because they can add emphasis, words such as "clearly," "special," "well," or "very" might seem to be the opposite of weasel words. In actuality, these intensifiers are so non-specific that they can be another type of "weaseling." Intensifiers raise questions such as "Significant compared to what?" and "Clearly according to whose criteria?" If you use intensifiers freely, two readers of the same report may be left with very different impression: Numbers such as 23 percent or \$3 billion tell a story, but just what does "very large" mean? "

4. “Auditee” is old-school.

A few years back, people undergoing an audit were most often referred to as “auditees.” Today, many experts believe that the phrase has negative connotations and that “auditee” implies someone who has something done to them by an auditor. Internal audit has become a collaborative process, and terms such as “audit client” and “audit customer” indicate that we are working with management, not working on them.

5. Avoid unnecessary technical jargon.

Every profession needs a certain amount of technical jargon, but the more we can avoid audit-speak, the more we can be sure that the message is clear. If you use more than one phrase such as “transactional controls,” “stratified sampling methodology,” or “asynchronous transfer mode” on a single page of an audit report, don’t be surprised when some of your readers check out without reading to the end the report.

6. Avoid taking all the credit.

It is tempting in audit reports to use phrases such as “internal audit found” or “we found.” Management will often bristle that you are taking credit for identifying something that wasn’t all that well concealed. It comes off like you threw them under the bus, and then backed over them.

7. It sounds impressive, you probably need a re-write.

Work to get readers to remember your recommendations and take action – not to impress with pompous words or bloated phrases. Avoiding jargon is only the beginning: Try substituting “by” for “by means of,” “now” for “at the present time,” and “so” for “so as to,” “for example.”

8. The problem is rarely universal.

It's good to be specific, but there's a danger in words such as "everything," "nothing," "never," or "always." "You always" and "you never" can be fighting words that can distract readers into looking for exceptions to the rule rather than examining the real issue. It's safe to say you tested 10 transactions and none were approved – less safe to say transactions are never approved.

9. Avoid the "blame game."

The purpose of internal audit reports is to bring about positive change, not to assign blame. We're more likely to achieve buy-in when our reports come across as neutral rather than confrontational. The goal is to get to the root cause rather than to call out the name of the guilty party. It's fine for a report to identify the party responsible for taking action on a recommendation – not so fine to say, "It was Fred's fault."

10. Don't say "management failed."

Making statements such as "Management failed to implement adequate controls" will invariably annoy those to whom we are looking to implement corrective action. Simply stating the condition without assigning blame through words like "fail" is much more likely to result in the needed corrective actions and help preserve our relationship with management for the next time we conduct an audit of their area.

The internal auditor should submit the report highlighting the severity of risk. High risk areas would be those where absence of immediate corrective action may have a major negative impact on achievement of objectives. Medium risks may be those areas where failure to take action could result in significant consequences. Low risk areas are those where suggested action would bring in greater efficiency or enhanced controls at minimal additional costs

The fifth-grader test

If an intelligent middle-school student couldn't understand your report, it may be needlessly complicated.

Lists like these are often very personal. This is not an all inclusive list and each team may like to create its own.

5.2 Issue of Report to stakeholders:

The audit reports should be issued to all the stakeholders who are required to take action on the report and who are included in the distribution list approved by the Audit Committee. This would necessarily include the Head of the organization of the audit unit and Head of the concerned Administrative Division.

5.3 Quality check of Audit Report:

Internal Audit Reports should be issued in the format prescribed by the O/o Controller General of Accounts (Annexure II). To ensure that these reports are effective, they should be complete, concise, accurate and objective and should be issued in a timely manner.

The Reports should be based on facts and free from any personal criticism. The audit findings should be worded constructively and the recommendations should focus on achievement of objectives.

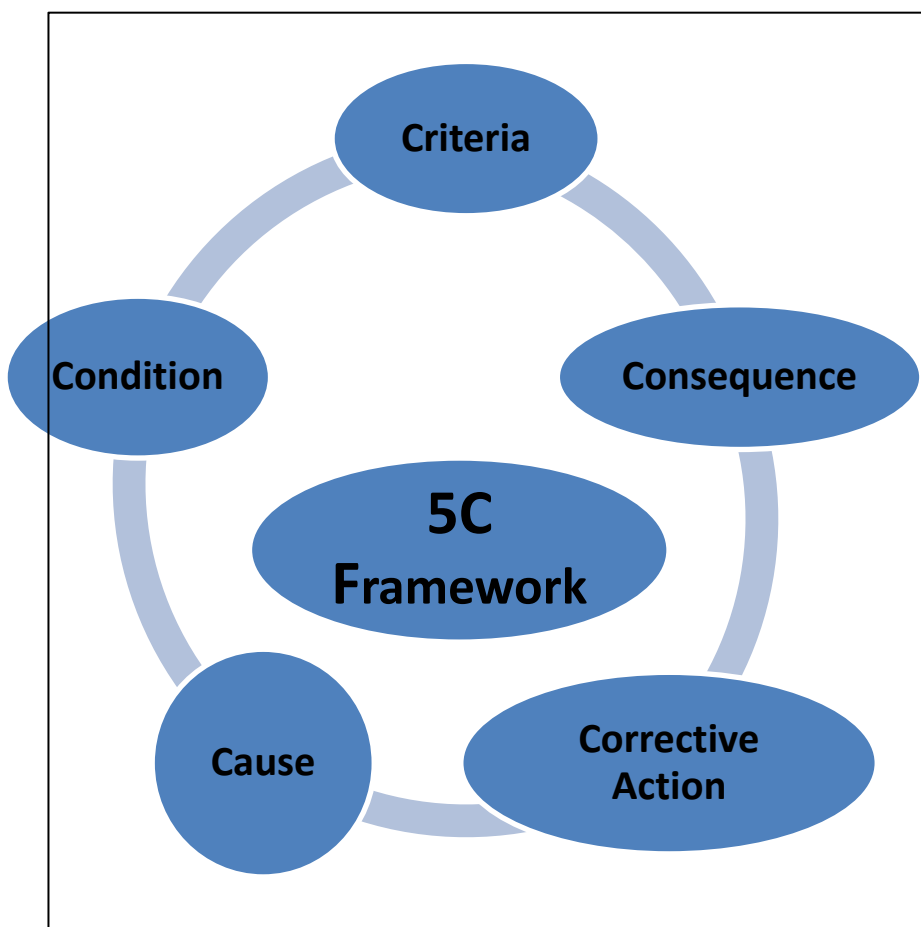
Other details which should be kept in mind include:

- The Reports should have proper spelling, grammar and punctuation.
- Fonts and formatting should be proper and consistent.
- Report addressee name and title should be proper and spelt correctly.

- Report number and subject title should be included correctly on the report.

5.4 Report drafted using 5C framework:

The audit observations should be developed by using 5C framework with reference to engagement objectives:



Criteria: What should exist? The benchmarks or expectations identified as the basis against which audit evidence is compared.

Condition: What exists? The factual evidence found in the course of the audit. The condition identifies the nature and the extent of the observation. A clear and accurate statement of condition evolves from the auditor's comparison of actual evidence with appropriate criteria.

Consequence/Effect/Impact: What effect did it have? The risk or exposure to the institution and/or others as a result of the difference between the criteria and the condition should be recorded. The effect establishes the actual or potential impact of the condition. The significance of a condition is usually judged by its effect. It can be expressed in quantitative terms. To warrant reporting, an effect should be sufficiently serious to justify the action (and related cost) to correct the difference (the deficiency).

Cause: Why did it happen? The possible or likely reason for the difference between the expected and actual condition should be explored. The cause may be obvious or may be identified by deductive reasoning. The identification of similar causes for a number of observations may highlight an underlying theme to which an audit recommendation should be addressed. Identification of the cause of an unsatisfactory condition is a prerequisite to making a meaningful recommendation for corrective action.

Corrective Action/Recommendation: What should be done? The actions suggested or required to correct the situation and prevent future occurrences. The relationship between the audit recommendation and the underlying cause of the condition should be clear and logical. In developing sound recommendations, the internal auditor ensures that the recommended action is within the scope of the entity, addresses the cause and not just the symptoms, and is at least intuitively viable.

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**FORMAT OF EXECUTIVE SUMMARY**

**1. Introduction**

- 1.1. Name of the unit audited
- 1.2. Period covered under current audit
- 1.3. Brief description of duties/functions of Auditee
- 1.4. Any other detail which may be relevant to present Audit

**2. Objective and Scope**

The objectives of this internal audit engagement were:

- 2.1.
- 2.2.
- 2.3. and so on.

**3. Scope of the Study**

The scope of this Internal Audit engagement included:

- 3.1.
- 3.2.
- 3.3. and so on

Individual audit engagement(s) should identify the key risks of audit units and evaluate the adequacy and effectiveness of controls designed to mitigate these risks. The audit engagement should detail the strengths and weaknesses in design and operation of the internal control systems and provide guidance for removing deficiencies noted during audit.

**3. Methodology**

This section should refer to the methodology adopted for conduct of internal audit engagement viz. Interview, Observation, Sampling, Sample size used for checking records, the number of records

checked, type of records checked. It should also include checklists (if any) used during the engagement.

#### **4. Results and Findings**

4.1 Strengths observed during the audit engagement.

4.2 weaknesses observed during the audit engagement.

The comments under these two categories should summarize each significant Audit observation in the order of materiality. The summary should be as brief as possible and draw on the observations under the Para on Consequence / Effect / Impact of each Audit observation. It should also include a summation of outstanding statutory and internal audit observations.

#### **5. Opinion**

Overall opinion of Audit Team about the functioning of Auditee Unit.

#### **6. Audit recommendations**

The recommendations of Audit Team on the observed weaknesses.

This could be presented in a box of highlighted print.

#### **7. Acknowledgement**

This section could acknowledge in brief the cooperation, acceptance of the criteria / findings and recommendations by the auditee (or otherwise). The observations should be stated in a factual and not in the form of an opinion (praise / accusation).

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Annexure -II

FORMAT OF THE DETAILED AUDIT REPORT

1. Introduction

- 1.1 Name of the Auditee (unit audited)
- 1.2 Period covered under current audit
- 1.3 Duration of Internal Audit (Indicate dates)
- 1.4 Brief description of duties/function of Auditee
- 1.5 Sanctioned strength and working strength
- 1.6 Budget / Expenditure of the auditee unit
- 1.7 Status of outstanding Statutory Audit observations
- 1.8 Status of outstanding Internal Audit Observations

2. Objective and Scope

Elaborate on the objective and scope of the audit engagement

3. Methodology

Elaborate on the methodology employed during the audit engagement.

4. Audit Observations

Each Audit Observation may be structured as described below

Audit Objective: To which Audit Engagement objective does this observation relate?

5. Recommendation

This section will have general recommendations if any which are not covered as part of recommendations in the specific Audit Observations.

6. Conclusion

This should constitute the auditors' overall opinion about functioning of the Auditee Unit. The strengths of the Auditee Unit may be highlighted in this section along with areas needing attention and corrective action.

7. Glossary

This section should have a Glossary of terms explaining technical and uncommon terms used in the Internal Audit Report.

8. References

This section should list all published material utilized and referred to in developing the Internal Audit Report.

9. Action Taken Report

This is to be completed by the auditee unit and forwarded to Internal Audit Wing of the Ministry/Department within 4 weeks of receipt of the Audit Report.

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**Annexure -III**

**GLOSSARY OF SOME COMMONLY USED TERMS**

The definitions/descriptions/meanings of the various terms used in this manual as well in Internal audit discussions are as follows:

- **Act** – Means Railway Act 1989 (Amended time to time)
- **Administrative Approval** means the formal approval or acceptance of the Administrative Department to a scheme, proposal or work for the purpose of incurring expenditure thereon. For every work (excluding petty works and repairs) it is necessary to obtain, in the first instance, the concurrence of the competent authority of the Administrative Department requiring the work.
- **Auditee Unit** means an organization (or office/unit part of an organization) that is being audited.
- **Audit Party** means the Composition of audit personnel as framed and approved in the audit programme of the respective Administrative Department.
- **Audit Programme** means a detailed plan of the auditing work to be performed, the procedures to be followed in verification, audit personnel involved and estimated time required to complete the audit.

- **Audit Sampling** means the application of audit procedures to less than 100% of the items to enable the auditor to obtain and evaluate audit evidence about some characteristic of the items selected, in order to form or assist in forming a conclusion.
- **Bank** means any branch of the State Bank of India acting as the agent of the Reserve Bank of India in accordance with the provisions of the Reserve Bank of India Act, 1934 (2 of 1934), any branch of a subsidiary bank as defined in section 2 of the State Bank of India (Subsidiary Banks) Act, 1959 (38 of 1959) which is authorised to transact Government business as agent of the State Bank of India, or any branch of a bank as may be appointed by the Reserve Bank of India as its agent under the provisions of sub-section (I) of section 45 of the Reserve Bank of India Act, 1934 (2 of 1934).
- **Entry conference** means the meeting or conference which is held at the beginning of each audit., The auditors meets with the management and staff to discuss the audit scope and objectives. Other areas which are discussed are estimated time frame for completing the audit; access to required

records, information and personnel; and management designation of a contact person for coordination purposes. Internal Audit will also ask for and consider management's suggestions for additional objectives to include in the audit or potential areas that may warrant special review.

- **Exit conference** means the conference which is held after the completion of Audit and is meant to communicate audit results to management and to obtain management's comments on proposed findings and recommendations before the audit report is issued. The issues presented at the exit conference may have been previously discussed with management. This is management's last opportunity to comment on the findings and recommendations prior to issuance of the report and their input is important to ensure that the audit results are fairly presented and that recommendations are reasonable and free of any errors or misrepresentations.
  
- **Budget Year** means the year commencing on the 1<sup>st</sup> of April and ending on the 31<sup>st</sup> of following March.

- **Code/Manual** means the relevant Code/Manual issued by Ministry of Railways (Railway Board). Details of Codes/Manuals issued by Railway Board are placed as Appendix.
- **Comptroller and Auditor General** means the Comptroller and Auditor General of India appointed under article 148 of the Constitution of India.
- **Competent Authority** means the Government or any other authority to which the relevant powers may be delegated by Government.
- **Contingency Fund Account** means the account of the moneys placed at the disposal of the Governor to enable advances to be made by him, for meeting unforeseen expenditure pending authorization of such expenditure by the State Legislature under appropriations made by law.
- **Completion Report** means after the completion of any project, the final Completion of completion Memo as per Engg. Code.
- **Computer Assisted Audit Techniques** means the practice of using computers to automate the audit process, which normally includes

using basic office productivity software i.e., spread sheets, word processors and more advanced software packages involving use of statistical analysis.

- **Controlling Officer** means a Head of a Department or other Departmental officer who is entrusted with the responsibility of controlling the incurring of expenditure and or the collection of revenue by the authorities subordinate to the Department.
- **Drawing and Disbursing Officer** means a Departmental officer who is entrusted with the responsibility of drawing and disbursing funds of the Government.
- **Finance Department** means the Finance Department of the Ministry of Railways.
- **Financial Year** means the year beginning on the 1<sup>st</sup> of April and ending on the 31<sup>st</sup> of March following
- **Internal Control** means the procedures adopted by the management of an entity to assist in achieving management's objective of ensuring the orderly and efficient conduct of its business, including adherence to management policies, safeguarding of assets, prevention and

detection of fraud and error, accuracy and completeness of the accounting records, and timely preparation of reliable financial information.

- **New Service or Scheme** means new form of a service or a new instrument of service which is contemplated newly for the first time and taken up after the sanction of the Legislature either through a new Demand Schedule or a Supplementary Demand Schedule.
- **Performance Audit** means an assessment of efficiency and effectiveness of the programmes, with due regard to economy and addresses the issues of inputs, processes, outputs (products) and outcomes (impact).
- **Peer Review** means an examination and review of systems and procedures employed by an internal audit team while conducting audit to determine the quality of audit services rendered. The review is done by another internal audit team on specific requisition or order.
- **Public Account** means the Public Account

- **Re-appropriation** means the transfer of funds from one unit of appropriation to another such unit.
- **Reserve Bank** means any office or branch of the Banking Department, of the Reserve Bank of India constituted under the Reserve Bank of India Act, 1934 (2 of 1934).
- **Risk Based Assessment** means the process of (i) Identifying and analyzing potential risks posing threat on the department's financial aspects as well as achievement of its objectives and (ii) Developing response to address the identified risks and prioritizing audit focus in the risk potential areas.
- **Risk Score Chart** means a score chart for assigning scores and ranks to the offices on the basis of the risk indicators.
- **ROR means** A rate of return is the gain or loss on an investment over a specified time period, expressed as a percentage of the investment's cost. Gains on investments are defined as income received plus any capital gains realized on the sale of the investment. Rate of return can also be defined as the net amount of discounted cash flows received on an investment.

- **Sampling** means the process of selecting a subset of the population of the items to draw inferences that represent the entire population.
- **Sundry Earning** means the Earning other than fare and freight which comes under Abstract 'C' of Finance code vol-II.
- **Value for Money Audit** means an independent assessment of the project, programme, scheme or of an organisations in terms of their goals and objectives and ascertaining the extent to which the expected results have been achieved from the use of available resources of men, money and materials.
- **Working Papers** means those papers which are formally referred to as (i) Audit documents or (ii) Audit file. The documents serve as proof of audit procedures performed, evidence obtained and the conclusion or opinion of the auditor.

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ABBREVIATIONS

AAP	Annual Audit Programme
AAO	Assistant Audit Officer
AR	Audit Report
ATR	Action Taken Report
APAR	Annual Performance Appraisal
AAC	Average Annual Consumption
CAAT	Computer Assisted Audit Techniques
CAGR	Compound Annual Growth Rate
CGA	Controller General of Accounts
CLW	Chitranjan Loco Works
CTS	Clean Train Station
CTR	Complete Train Report
CDO	Coaching Depot Officer
CWM	Chief Workshop Manager
CRIS	Centre for Railway Information systems
COIS	Coaching Operation Information System
CCTV	Close Circuit Television
DDO	Drawing and Disbursing Officer
D&G	Departmental & General
DRF	Depreciation Reserve Fund
FA & CAO	Financial Advisor & Chief Accounts Officer
FOIS	Freight Operation Information system
GTKM	Gross Tonne KM
GFR	General Financial Rule
GAD	General Arrange Drawing (?)
GCC	General Condition of Contract
HoD	Head of Department
HQ	Head Quarter Office (Zonal HQ)

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HSD	High Speed Diesel
HHP	High Horse Power
IAMC	Internal Audit Monitoring Cell
IACRC	Internal Audit Compliance Review Committee
MMIS	Material Management Information System
MACLS	Multiple Aspect Color Light Signal
MDW	Diesel Modernisation Workshop/Patiala
NTKM	Net Tonne KM
JS	Joint Secretary
JPO	Joint Procedure Order
KWH	Kilo Watt hour
KPI	Key Performance Indicator
LED	Light Emitting Diode
LD	Liquidity Damage
MPR	Monthly Progress Report
M & P	Machine & Plant
OBHS	On Board House Keeping Scheme
PG	Performance Guarantee
POH	Periodical Overhaul
PLF	Plant Load Factor
PO	Purchase Order
RSC	Risk Score Chart
RRI	Route relay Interlocking
RDSO	Research, Design & Standard Organization, LKO
SR	Subsidiary Rule
SEC	Specific Electricity Consumption
SFC	Specific Fuel Consumption
SD	Security Deposit
SBD	Standard Bid Document

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TCM	Tender Committee Minutes
UC	Utilisation Certificate
ROR	Rate of Returns

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**SAMPLE REPORT FOR GUIDANCE - 1**

The following is a report submitted by COFMOW which meets most of the parameters of a good report

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**Study on Prompt Approval of GAD Drawings and Other Issues required for Timely Commissioning of machines procured by COFMOW**

**PURPOSE OF STUDY**

Since its inception in 1979, COFMOW has been acting as a central agency for procurement, delivery and commissioning of high value machinery & plant (M&P) items, for Indian Railway (IR) workshops, sheds and Production Units (PUs). M&P items procured by COFMOW are used for repair & maintenance of rolling stock in workshops & sheds and for production of new rolling stock in Production Units. Augmentation and maintenance of locomotives, carriages and wagons and other items of plant and machinery is of paramount importance for IR, in order to meet its targets of carrying passengers and freight and earning revenue from these operations,

**OBJECTIVES OF STUDY**

- 1) To see whether machinery procured by COFMOW is delivered and installed, as per prescribed schedule.
- 2) To assess which activities lead to delays in delivery and commissioning of machines, the extent of delays and reasons for delays.
- 3) To assess whether the supplier and the user (consignee) are fulfilling their roles and responsibilities for timely delivery and commissioning of machines as prescribed by COFMOW in the AT.

- 4) To assess whether the time schedule for various activities prescribed by COFMOW is realistic and achievable.
- 5) To understand the problems faced in delivery & commissioning of M&P.
- 6) To take corrective and preventive action for ensuring timely delivery and commissioning of machines supplied by COFMOW.

## **SCOPE OF STUDY**

Since timely completion is the essence of any contract, it was decided to study the compliance to the time schedule for various activities involved in supply and commissioning of M&P as prescribed in Advance Acceptance of Tender (AT) issued by COFMOW.

It was decided to focus on critical activities, delay in which attracts levy of penalty (LD) on firm, such as:

- 1) Submission of Performance Bank Guarantee (PBG) by Firm (LD 2% p.m.).
- 2) Submission of General Arrangement Drawings (GAD) by Firm (LD 0.25% per week).
- 3) Approval of General Arrangement Drawings (GAD) by Consignee.
- 4) Handing over of Site by Consignee.
- 5) Construction of foundation by Firm.
- 6) Supply of Machine by Firm (LD 2% p.m. max 10% along with LD levied at previous stages).
- 7) Installation & Commissioning of Machine by Firm (LD 2% p.m. max 10%)
- 8) Issue of Prove-out Test Certificate (PTC) by consignee.

## **SAMPLE SIZE CRITERIA AND SELECTION**

COFMOW has been procuring machines for Indian Railways since 1979 to seven Production Units (PUs), 45 railway workshops and 100 loco sheds located over 17 zonal railway systems. In the two-month time for this study, it was not possible to cover all the

## *Manual For Internal Audit on India Railways*

purchases made by COFMOW for these units/consignees. So it was decided to base sample size for study on number of units/consignees, year of purchase and cost of machines, as follows:

**UNITS/CONSIGNEES:** It was decided to study supplies to eight units i.e. three PUs, four workshops and one loco shed, covering four zonal railways, as follows:

**Period of procurement:** It was decided to select machines from those procured during the last FIVE years (2011 to 2015).

**Cost of machine:** For this study, it was decided to select high value machines costing Rs. 1 crore or more. However, if such machines were few in some units, machines of lower cost but above Rs. 10 lakhs were also selected. With these cost considerations for each unit, machines were selected at random. No prior information regarding delays in scheduled activities was considered for selection of machines.

### **METHODOLOGY**

For the units selected, the details of ATs issued in the past three years was obtained from MIS system of COFMOW. These details

| SNo | Name of Unit                                       | 2011     | 2012      | 2013      | 2014      | 2015      | TOTAL     | Cost Range<br>(Rs. In lakhs) |
|-----|----------------------------------------------------|----------|-----------|-----------|-----------|-----------|-----------|------------------------------|
| 1   | Diesel Loco Modernisations Works (DMW), Patiala    |          | 3         | 3         | 2         | 4         | 12        | 200 to 2170                  |
| 2   | Deisel Loco Works , Varanasi                       | 2        | 1         | 2         | 3         | 3         | 11        | 31 to 940                    |
| 3   | Rail Wheel Factory, Bangalore                      |          | 3         |           | 2         |           | 5         | 21 to 797                    |
| 4   | Carriage &Wagon Repair Workshop(CWRS), Bhopal, WCR |          |           | 4         | 3         | 1         | 8         | 11 to 300                    |
| 5   | C&W Workshop, Jodhpur,NWR                          |          | 2         | 1         | 1         |           | 4         | 11 to 627                    |
| 6   | Mechanical Workshop, Amritsar, NR                  |          | 3         |           |           |           | 3         | 140 to 343                   |
| 7   | Diesel Loco Shed (DLS), Abu Road, WR               | 1        | 2         | 1         | 1         | 1         | 6         | 11 to 68                     |
| 8   | .C&W workshop, Jhansi , NCR                        |          | 2         | 3         | 5         | 1         | 11        | 147 to 931                   |
|     | <b>TOTAL</b>                                       | <b>3</b> | <b>16</b> | <b>14</b> | <b>17</b> | <b>10</b> | <b>60</b> |                              |

included AT number, machine name, AT date, quantity, cost, name of supplier, etc.

Total 60 machines were selected as per criteria indicated in para 4 above. The unit-wise and year-wise breakup of sample machines selected is summarised below:

### *Manual For Internal Audit on India Railways*

The delay in completion of each activity was worked out by comparing the actual dates and scheduled dates for the activity. Efforts were made to ascertain the reasons for delay and responsibility for delay (Supplier or consignee).

Discussions were held with concerned consignees and COFMOW officials regarding problems faced in adherence to time schedule for commissioning of machines supplied by COFMOW and any corrective /preventive steps required for eliminating delays in supply and commissioning.

### **OBSERVATIONS & DATA ANALYSIS**

A sample of the time schedule prescribed for various activities in the Acceptance of Tender Document (AT) by COFMOW is indicated below:

| Activity                                                      | Scheduled time                                                         |
|---------------------------------------------------------------|------------------------------------------------------------------------|
| Issue of LOA by COFMOW                                        | D1                                                                     |
| Submission of Perf. Bank Guarantee (PBG) by supplier          | D1+30 (30 days from LOA)                                               |
| Issue of AT by COFMOW                                         | D2+30 (30 days from PBG)                                               |
| Opening of LC (in case of imported purchase)                  | D3+30 (30 days from AT)                                                |
| Submission of General Arrangement Drawings (GAD ) by supplier | D1+30 (30 days from LOA)                                               |
| Approval of GAD by consignee                                  | D5+30 or 45 (30 or 45days from submission)                             |
| Handing over clear site by consignee                          | D5+30 or 45 (30 or 45days from submission)<br>Or D9-90 (90 days before |

|                                                  |                                                                                                                     |
|--------------------------------------------------|---------------------------------------------------------------------------------------------------------------------|
|                                                  | delivery)                                                                                                           |
| Construction of foundation by supplier           | D7+120 (120days from site)                                                                                          |
| Delivery of machine at site by supplier          | D4+240 (eight months from LC) for imported<br>Or D3+240 (240 days from AT)<br>Or D6+180(180 days from GAD approval) |
| Installation of machine by supplier              | D10+30 (30 days from supply)                                                                                        |
| Commissioning of machine by supplier             | D11+30 (30 days from installation)                                                                                  |
| Issue of Prove-out Test Certificate by consignee | D12+30 (30 days from commissioning)                                                                                 |

The data collected was regarding progress of various activities/stages, from issue of AT to commissioning, for each of the sample 44 machines. For each machine there could be one or more activity showing delay. Also many machines show delay in the same activity.

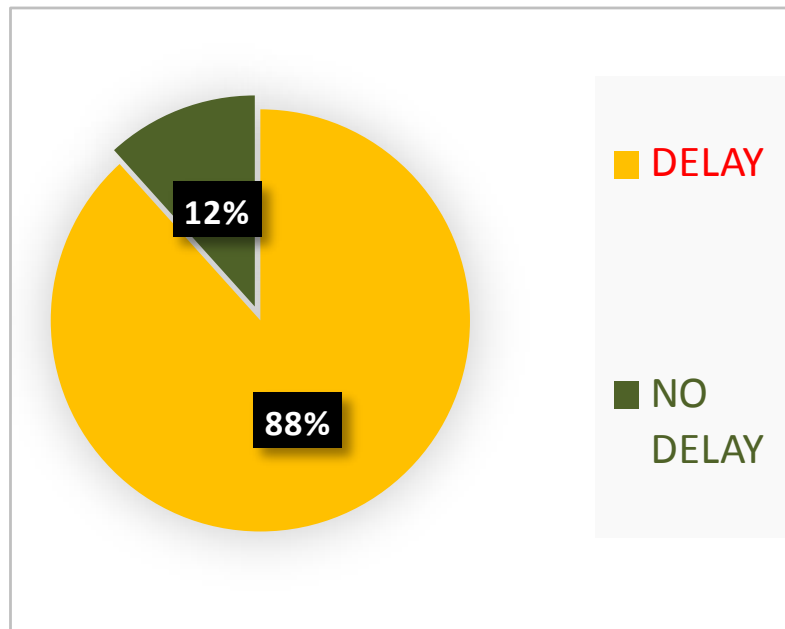
To study the impact of delays, the data was sorted activity-wise to bring out the number of machines for which that particular activity was delayed, the extent, responsibility and reasons for the delay.

The sorted data is shown in Annexure 2 Tables A and B1 to B8. On analysis of the data the following points were observed:

### **FREQUENCY OF DELAYS**

There are eight main activities/stages involved in commissioning of machines. Out of 60 of machines selected, there was no delay in any activity in case of only 7 machines (12%), which are listed at Annexure 2 table A.

Delay in some activity occurred in 53 machines (88% of sample).



| S.No. | Activity delayed           | Frequency<br>of delayed<br>activity<br>(number of<br>machines) | % of 53<br>delayed | RESPONSIBILITY<br>FOR DELAY<br>(F-Firm,<br>R-Railway) |
|-------|----------------------------|----------------------------------------------------------------|--------------------|-------------------------------------------------------|
| 1     | Submission of PBG          | 12                                                             | 23%                | F                                                     |
| 2     | Submission of GAD          | 17                                                             | 32%                | F                                                     |
| 3     | Approval of GAD            | 28                                                             | 53%                | 26-R, 2-F                                             |
| 4     | Handing of Site            | 18                                                             | 34%                | R                                                     |
| 5     | Construction of Foundation | 13                                                             | 25%                | 8-F, 3-R, 2-F & R                                     |
| 6     | Delivery                   | 23                                                             | 43%                | 22-F, 1-R                                             |
| 7     | Commissioning              | 22                                                             | 42%                | 16-F, 5-R, 1-F&R                                      |
| 8     | Issue of PTC               | 15                                                             | 28%                | R                                                     |

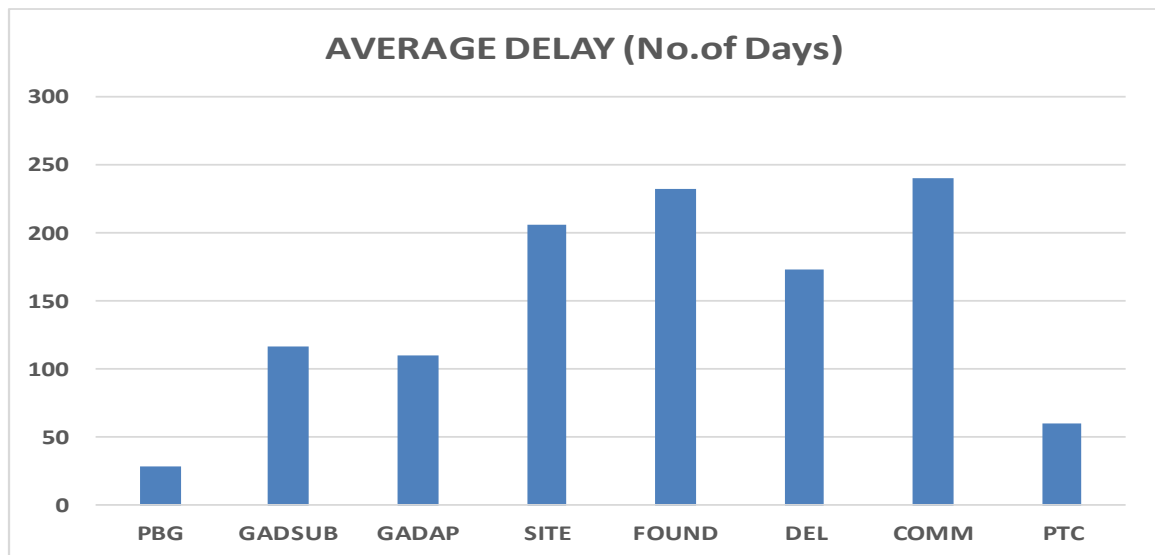
Delays  
occur  
most

frequently in either approval of GAD drawing or delivery or commissioning. Out of the 53 machines having delay in some activity, maximum (28) showed delay in approval of GAD, 23 in delivery and 22 in commissioning. The responsibility of delay in approval of GAD drawing is mostly with consignee while that of delay in delivery and commissioning is with firm.

Out of the above, 12 machines showed delay in all three stages i.e GAD approval, delivery and commissioning (AT numbers are G 645, OP 2180, G 560, OP 2110, G-687, G-622, OP-2159, OP 2141-two machines, G-599, OP-1883, OP-21178, OP-2269), showing that delay in approval of GAD drawing results in delay in delivery and commissioning also.

Delay in submission of GAD by firm and handing over site by consignee were also frequent. However, there was no direct link between delays in submission and approval of GAD. In fact, cases of delay in submission of GAD are only 17 compared to 28 cases of delay in approval off GAD by consignee.

Out of 18 machines in which there was delay in handing of site only 4 showed delay in construction of foundation also. So no relation was established between these activities. In fact, the delay in construction of foundation by firm was least frequent indicating that



even though the handing over of site by consignee was delayed, foundation was completed in time by firm in most cases.

Delayed issue of PTC by consignee was also found in 15 (28 %) of machines.

## **CONCLUSIONS**

From issue of LOA to issue of PTC there are 8 important activities. The Firm (supplier) is responsible for 5 activities i.e. (i) submission of

PBG (ii) submission of GAD drawing, (iii) construction of foundation (iv) delivery of machine and (v) commissioning and prove out of machine. Delay in submission of PBG, delivery and commissioning attract levy of LD on firm. Consignee is responsible for 3 activities i.e. (i) approval of GAD drawings, (ii) handing over of site and (iii) issue of PTC.

There is delay in some or more activities in most of the machines (75%) supplied by COFMOW.

The third most frequent delay was in commissioning of machines followed by delay in handing over of site.

Delay in construction of foundation by firm was least frequent indicating that even though the handing over of site by consignee was delayed, foundation was completed in time by firm in most cases.

## **RECOMMENDATIONS**

### **FOR CONSIGNEES**

In the PTC the actual dates of completion of each activity should be shown against the due dates as per COFMOW time schedule prescribed in AT, along with period of delay, if any.

Clear reasons for delays should be indicated along with whether responsibility of delay is on part of consignee or firm.

Loss due to delays needs to be quantified in terms of non utilisation of capacity of machine, lower output and efficiency etc.

All efforts should be made by consignee to provide the required infrastructural facilities like power connection, covered shed etc. along with or immediately after provision of site, so that the firm does not get any excuse for delay in supply and commissioning.

**FOR COFMOW**

In the time schedule prescribed by COFMOW, handing over of site by consignee should be linked to issue of AT only and not to approval of GAD or to delivery.

A suitable period for provision of infrastructural facilities like power connection, covered shed, etc. by consignee should also be provided in COFMOW time schedule.

A system of reporting after completion of each important activity by consignee to COFMOW, like submission and approval of GAD, handing of site, readiness of site, completion of foundation, delivery and installation of machine should be developed. Adherence to time schedule for each activity should be monitored regularly and corrective action to prevent delays taken regularly.

If it is noticed that an activity, delay in which attracts levy of LD on the firm, is getting delayed for reasons attributable to the consignee, request for extension of time period for that activity should be received from the firm. If found justified suitable extension of time period should be granted by COFMOW with or without LD to avoid levy of LD and subsequent representations by the firm. Refixation of delivery period/ refund of LD already levied on representation by firms should only be in very exceptional cases.

**SAMPLE REPORT FOR GUIDANCE - 2**

The following is a report submitted by SECR which meets most of the parameters of a good report

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**Theme Based System Audit Report on “Revision and levy of Land License Fee of Private Sidings of SECR**

**OBJECTIVES OF THE STUDY**

The study was done to meet the following objectives:-

Review of Present Working System:- Whether effective system is in place for proper calculation and recovery of license fee at Divisional and HQ level. The present role of Engineering Department and Accounts department as well has been reviewed.

Implementation of Rules and Procedures:- Whether land license agreement for the new sidings are being done as per the laid down rules and procedures and the License Fee, Security Deposit etc. are being calculated and imposed as per Railway Board guidelines.

Maintenance of Records:- Whether proper monitoring mechanism is in place to ensure that records of different sidings such as land agreement, land rates, documents in support of land area, calculation sheets for land license fee etc. are being maintained properly.

To Stop leakage of Railway Revenue:- Whether the Railway revenue from the land license fee has been fixed as per relevant rules and the same has been realized in the railway exchequer on time. Proper penalty, for any infringement has been recovered.

## **SCOPE OF STUDY**

The theme based study of “Revision and Levy of Land License Fee of Private Sidings of SECR” has been done for those private sidings only that has land license agreement with Railway and/or paying land license fee and being operated in Nagpur, Raipur and Bilaspur Divisions of SECR. Data pertaining to a total number of 49 private sidings (21- Bilaspur, 22-Raipur, 6- Nagpur) have been collected, checked and analyzed for this study. The private sidings using their own land (i.e. not using railway land at all) or having long term lease agreements with railway have been excluded from the study. It is noted that a number of old sidings running presently but whose land agreements are not available are also studied in preview of system audit. Various related items such as Revision of land license agreements, to review the correctness of annual increase in the land rates chargeable to the sidings, to ascertain recovery of Service tax as applicable from time to time etc. have been taken within the scope of this study.

Authority: - 1. FC( Rlys.)’s letter No.-2015-16/AC-II/20/16 dated 27.10.2015.

2. FA&CAO/BSP’s letter No.- SECR/HQA/I&E/System Audit/2015-16/754 dated 30.10.2015.

**RELEVANT RULES OF RAILWAY BOARD** Accordingly, the levy of Annual License fee of a private siding depends upon two factors- (i) Area of the land licensed and (ii) Total value of the land licensed.

**Area of the land:-** Area of the land licensed to the private sidings should be measured by the Engineering Deptt. The standard unit of measurement should be taken as “Sq. Meter”.

**Total value of the land:-** Total value of land is calculated by multiplying the respective total Area of land with the respective current rate of the land. Current rate of the land should be taken from the concerned revenue authorities for the year of notification of the siding. If current rates are not available then the rate of land is

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calculated with the old rates available with 10% increase per year w.e.f. 01.04.1986 upto 01.04.2004 and with 7% increase from 01.04.2004 onwards. The standard unit of land rates should be taken as “Rs. per Sq. Meter”.

Thus, the Annual license fee applicable depends upon two factors –  
6% of the total land value or

Rs.1000/- per unit Area of the land whichever is more.

Where one unit area is defined as maximum 100 Sqm.(in the calculation residual area of less than 100 Sqm is also taken as one unit). For example 250 Sqm area = 3 units. Annual license fee is increased by 7% of previous value each year.

Security Deposit applicable for the land license is equal to the Annual license fee in a particular year. Since, License fee increases each year, the increased value of Security Deposit is levied simultaneously.

### **METHODOLOGY FOR STUDY**

The methodology adopted for this study involves the following steps:-

Collection of Data pertaining to Private Sidings.

Analysis of data as per relevant rules.

Checking of short charging, delay in payments etc. if any.

Finding out the causes of errors, violations of rules, delay in payments, etc.

Discussion with dealing branches regarding deficiency in the system on the subject.

Corrective actions advised.

Data such as- Name of the siding, Division/Place, Date of Notification, Date of Agreement Land Area, Value of Land on the date of Agreement, Annual License Fee, Security Deposit, Date of Revision of Licence fee, Amount realized as on date, Balance to be realized

etc. pertaining to each siding have been collected through letters, e-mails, personal visits and on-spot checking of records available at executive offices.

All data pertaining to a particular private siding is arranged and classified year wise to analyse whether the License Fee actually calculated is at par with the prevalent rules and guidelines. It is find out that how much of such income has been realized and the balance to be realized actually. The detailed statement of calculation is enclosed as Annexure-‘B’ for BSP/Div, Annexure-‘C’ for R/Div and Annexure-‘D’ for NGP/Div.

### **OBSERVATIONS:**

It is observed that as per records provided by executive offices a considerable amount of License Fee amounting to Rs.398 Lakhs [Rs.8465052.00(BSP/Div.)

+Rs.31509432.00(R/Div)+Rs.0.00(NGP/Div)] is outstanding, and to be recovered from the siding holders in the current financial year. However this figure shoots up to the tune of Rs. 478 Lakhs [Rs.8465052.00 (BSP/Div.) + Rs. 31509432.00 (R/Div) + Rs.7863435.00 (NGP/Div) = Rs. 47837919.00] as per valid calculation. This considerable difference indicates the following:-

Delay in the recovery of railway dues.

Non Revision of License Fee on due course.

Short charging of License Fee due to wrong calculation of the same or otherwise.

Annual review of the Levy of License fee is not being done properly.

Calculation statements showing the fixation of Land License Fee is not being submitted for vetting to the associated accounts, particularly in NGP/Div.

It is evident from the findings that in most of the cases, the revision of License fee has not been done on due date on quinquennial Basis as per para 1024E . In some cases the Land License Agreement has not been finalized even after years of commencement of sidings and

in those cases only a nominal license fee is being recovered as recommended by the HOD committee's recommendation on that particular siding.

As on date there is no proper set up of Land Management cell at HQ and divisional level. However, after the inspection of executive offices of division dealing the matter, it is observed that proper siding register is not being maintained, and so various details of different sidings are not available at a single place. However, the bill-raising register is being maintained properly.

Recently, the market/Govt. rate of land has considerably increased in Chhattisgarh/Maharashtra/Odisha states year by year, however the revaluation of Railway land is being done once in a 5 years resulting in loss of railway revenue. Also the revision period of 5 years is linked from the date of commencement of the siding. It is proposed that revaluation of railway land should be linked with the revision of land values by the state concerned.

## **CONCLUSION AND SUGGESTIONS**

Considering the use of valuable Railway land by the private sidings the following structural improvements are proposed regarding levy of land license fee to curb leakage of railway revenue-

A computerized siding module should be developed on the basis of FOIS for online registration of all basic and variable data of a siding regarding their commencement, payment, holdings etc. A unique ID number (like PF Number in case of Employees) should be allotted to each Private Siding, so as to collect and classify the data related to a particular siding in a unique manner and thus stop duplication of data.

Service tax applicable on the sidings should be levied and collected as per CBDT circulars without delay.

Address and phone numbers of the siding holders should be collected periodically, incorporating the changes if any. Presently this is unavailable for a number of sidings.

Bills recoverable for revised License Fee, difference of SD thereon, and other charges should be prepared and sent to the party before the due date; parties should be allowed to pay the same on or before the due date. A Policy should be framed in such a way that some grace period should be fixed for delay payment and a fixed interest payment is imposed for any payment made afterwards, without requirement of any competent sanction.

Documentary evidences in support of the value of land leased long ago are very old and have not been renewed from the States land department. 'Land' being the subject of state list under the constitution of India, Land documents should be renewed and should be at par with the land policy of the State concerned. Online facilities from the states in this regard should be checked and used.

A new policy guideline should be formulated at Railway Board level regarding the term for revaluation of Railway land, so that inherent loss of railway revenue from licensing/leasing of land due to price escalation in the real estate sector may be conquered. In long term cases of leasing Board may consider a pre fixed auto revaluation of land linking it with bank rates.

Railway should conduct periodical on spot checks to see if the railway land is being put to additional/alternative use or for any other purpose for which land has been licensed. If so found, proper stringent action should be taken against the party. It should be ensured by on spot checking that the Railway land is taken back from the Licensee after the expiry of license agreement.

In this connection the Nodal officers joint report suggested for structural changes as under to streamline the Revenue from licensing of Railway land to outsiders :-

Land agreement plan needs to be developed preferably by approved consultant, to avoid delay and preparation as per laid down keeping in view railways rule in force. The subject drawing should be got approved at appropriate level.

A target date shall be fixed for applying land licensing to the railway through proper channel for which the siding authorities would

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require to apply for land licensing. The drawing will indicate separate railway land for separate market value.

After approval of the GM/SECR based on the HOD's recommendation, a tight schedule should be given to the siding authorities for execution of agreement.

Based upon the amount so arrived as above the siding authorities should pay the land licensing fee.

For payment of arrears based upon the date from which the opening of siding was notified.

If amount paid were on lesser side, they would require to pay arrears. In case the amount paid is on higher side, the excess amount will not be refunded but adjusted in future payment of license fee.

## **References:**

The information in this Manual has been culled from various sources as acknowledged below:

- 1) Generic Internal Audit Manual for Central Civil Ministries of Government of India published by Ministry of Finance, Department of Expenditure O/o Controller General of Accounts Internal Audit Division.
- 2) Compendium of Standards on Internal Audit (as on July 1, 2013) published by the Institute of Chartered Accountant of India, New Delhi.
- 3) A New Era in Internal Audit-Companies Act, 2013 published by the Institute of Chartered Accountant of India, New Delhi.
- 4) Internal Audit Manual 2014 published by Government of Odisha.
- 5) Internal Audit Manual published by Government of Andhra Pradesh.
- 6) Guide on Risk Based Internal Audit Plan published by the Institute of Chartered Accountant of India, New Delhi.

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### **APPENDIX**

| PART A - Act                       | PART B - Codes                                                         | PART C - Manuals                                                          | Others                                                                                   |
|------------------------------------|------------------------------------------------------------------------|---------------------------------------------------------------------------|------------------------------------------------------------------------------------------|
| Indian Railway Board Act, 1905     | Indian Railways Administration and Finance an Introduction             | Indian Railways Establishment Manual Volume-I                             | Rules for entering into Supply Contracts                                                 |
| The Railways Act, 1989             | Indian Railways Code for the Accounts Department Part - I              | Indian Railways Establishment Manual Volume-II                            | Manual of Statistical Instructions Voulume - I                                           |
| Railway Protection Force Act, 1957 | Indian Railways Code for the Accounts Department Part - II <b>NEW!</b> | Indian Railway Commercial Manual Volume-I                                 | Manual of Statistical Instructions Volume - II                                           |
|                                    | Indian Railways Finance Code Volume - I                                | Indian Railway Commercial Manual Volume-II                                | Railway Board's MOP                                                                      |
|                                    | Indian Railways Finance Code Volume - II                               | Indian Railways Work Manual                                               | Consolidated List of Subjects Dealt with by Various Branches in the Ministry of Railways |
|                                    | Indian Railways Establishment Code Volume- I                           | Indian Railways Permanent Way Manual                                      |                                                                                          |
|                                    | Indian Railways Establishment Code Volume - II                         | Manual for fusion Welding of Rail By the Alumino-Thermic Process          |                                                                                          |
|                                    | Indian Railways Code for Traffic (Commercial) Department               | Manual For Flash Butt Welding of Rails                                    |                                                                                          |
|                                    | Indian Railways Code for the Stores Department Voulume - I             | Manual to Glued Insulated Rail Joints                                     |                                                                                          |
|                                    | Indian Railways Code for the Stores Department Volume - II             | Indian Railways Manual of AC Traction Maintenance and Operation Volume- I |                                                                                          |
|                                    | Indian Railways Code for the Engineering Department                    | Indian Railways Manual of AC Traction Maintenance                         |                                                                                          |

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|--|----------------------------------------------------------------------|----------------------------------------------------------------------------------------------|--|
|  |                                                                      | and Operation Volume-II<br>(Part- I)                                                         |  |
|  | Indian Railways Code for the<br>Mechanical Department<br>(workshops) | Indian Railways Manual of<br>AC Traction Maintenance<br>and Operation Volume-II<br>(Part-II) |  |
|  | Railways service (Pension) Rules -<br>1993                           | Indian Railways Manual of<br>AC Traction Maintenance<br>and Operation Volume -<br>III        |  |
|  | Operating Manual for Indian<br>Railways                              | Compendium of<br>Instructions on AC & TL<br>Coaches                                          |  |
|  |                                                                      | Indian Railway Medical<br>Manual Volume-I                                                    |  |
|  |                                                                      | Indian Railway Medical<br>Manual Volume-II                                                   |  |
|  |                                                                      | Indian Railway Small<br>Track Machine Manual                                                 |  |
|  |                                                                      | Indian Railway<br>Telecommunication<br>Manual                                                |  |
|  |                                                                      | Indian Railways Track<br>Machines Manual - RDSO                                              |  |
|  |                                                                      | Signal Engineering Manual<br>Part - I                                                        |  |
|  |                                                                      | Signal Engineering Manual<br>Part - II                                                       |  |