National Dairy Support Project
Annex 1 - Checklist for Financial Management Review by Project External Auditors

Name of the End Implementing Agency: Indore District Co-operative Milk Producers' Union Ltd.

Date of Audit Review/Visit: 1st & 2nd September, 2016

<table>
<thead>
<tr>
<th>Sr. No.</th>
<th>Description of Sub Project</th>
<th>Date of Sanctioned Amount</th>
<th>(£ in million)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Ration Balancing Programme (RBP)</td>
<td>01-Apr-15</td>
<td>20.135</td>
</tr>
<tr>
<td>2</td>
<td>Fodder Development (FD)</td>
<td>12-Oct-12</td>
<td>5.47</td>
</tr>
<tr>
<td>3</td>
<td>Village Based Milk Procurement System (VBMPS)</td>
<td>12-Oct-12</td>
<td>20.038</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Sr. No.</th>
<th>Particulars</th>
<th>RBP</th>
<th>FD</th>
<th>VBMPS</th>
<th>Yes / No / NA</th>
<th>Observations / Suggestions</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Sub Project appraisal included assessment of End Implementing Agency's (EIA) Financial Management (FM) arrangements through FM checklist.</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2</td>
<td>In case of weaknesses identified, a time lined action plan has been agreed between PMU and the EIA and reflected in the Sanction Letter/Grant Agreement.</td>
<td>NA</td>
<td>NA</td>
<td>NA</td>
<td></td>
<td></td>
</tr>
<tr>
<td>3</td>
<td>The criteria as given in the PIP have been applied by PMU in assessing the eligibility of the EIA and adequate documentation is available evidencing such appraisal.</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td></td>
<td>We observed that the EIA has failed to bring the contribution as required under the project guidelines for the purpose of acquisition of capital assets during the year. However, subsequent to the year end, the EIA has brought in their contribution.</td>
</tr>
<tr>
<td>4</td>
<td>The EIA has raised/brought in their contribution as stipulated in the Grant Agreement.</td>
<td>NA</td>
<td>NA</td>
<td>No</td>
<td>Refer MLP #1</td>
<td></td>
</tr>
<tr>
<td>5</td>
<td>The EIA is maintaining a separate dedicated project bank account and project transactions are routed through this account.</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td></td>
<td></td>
</tr>
<tr>
<td>6</td>
<td>The project bank account is duly reconciled and exceptional entries have been followed up.</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td></td>
<td></td>
</tr>
<tr>
<td>7</td>
<td>Project transactions are recorded in the books of the EIA under separate account heads reflecting at least the expenditure items in the Grant Agreement.</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>Refer MLP #2 Refer MLP #2 Refer MLP #2</td>
<td></td>
</tr>
<tr>
<td>8</td>
<td>The FUCs submitted by the EIA to PMU is in conformity with the books of the EIA.</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>Refer MLP #2 Refer MLP #2 Refer MLP #2</td>
<td>In absence of separate trial balance for sub-project transactions, we have verified that total expenditure as claimed in FUC agrees with total bank outflow.</td>
</tr>
<tr>
<td>9</td>
<td>The expenditure reported in the FUC is duly evidenced by adequate supporting documentation evidencing receipt of goods/services, approved as per the EIAs delegation of powers and payments made are as per the contractual obligations.</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td></td>
<td></td>
</tr>
<tr>
<td>10</td>
<td>Assets created under the project have been recorded in the asset records of the EIA and physically verified.</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Refer MLP #4 Refer MLP #4 Refer MLP #4 Refer MLP #4</td>
</tr>
<tr>
<td>11</td>
<td>The FUC has been reviewed and approved by PMU and the sub project expenditure has been recorded in the books of PMU (as grouped for reporting) under appropriate account heads.</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td></td>
<td></td>
</tr>
<tr>
<td>12</td>
<td>Based on the above review, in the auditor's opinion, are there any serious concerns in the FM systems of PMU/EIAs that may impair their capacity to provide fiduciary assurance, including reporting, on use of Project funds. If the answer to the above is yes, please elaborate these concerns.</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>(Refer Management Letter issued) (Refer Management Letter issued) (Refer Management Letter issued)</td>
<td></td>
</tr>
</tbody>
</table>

For Deloitte Haskins & Sells LLP
Chartered Accountants

Kartikeya Raval
Partner
Ahmedabad, January 2017
1. **Short-contribution by EIA in sub-project bank account**

**Observation**

During the course of audit, we observed that EIA was not regular in depositing the contribution required to be deposited under VBMPS Project for the F.Y. 2015-16. Out of total contribution of ₹ 2.81 Million required to be brought in by EIA for the purpose of this sub-project, EIA has not brought any amount till March 31, 2016.

We observed that while verifying FUC, PMU observed short-fall in matching contribution from EIA and hence followed-up with EIA instructing them to bring in necessary contribution. Consequently, EIA has deposited matching contribution in April – June 2016 quarter.

**Implication**

Failure to bring-in necessary contribution to the sub-project bank account tantamount to violation of Para 5.6 of FMH which mandates that, in order to maintain appropriate audit trail, the EIA must first deposit necessary contribution in sub-project bank account and then the payment to supplier should be released in full from sub-project bank account.

**Recommendation**

We suggest that EIA should establish a procedure whereby it is ensured that the necessary contribution towards sub-project expenditure is deposited in sub-project bank account by EIA before releasing payment to the supplier. Further, PMU should monitor and timely communicate to EIAs in case there are any lapses in depositing necessary funds to sub-project bank account.

**Management Response**
National Dairy Plan – Phase I  
Indore Milk Union

2. **Separate books of account for each project and Accounting for Fixed assets acquired under the sub-project and depreciation**

**Observation**

During the course of audit, we observed that EIA does not maintain separate books of account for the projects under NDP-1. EIA maintains separate NDP Fund account for each project under the head "sundry creditors" in its existing set of books of account. All the expenses under the project are debited to this account.

In absence of separate books, sub project wise trial balance cannot be generated from the system and hence we could not observe direct linkages between books of EIA and FUC as explained in para 6.2 of Financial Management Handbook (FMH).

Assets are not separately recognized in the accounts under the project and hence verification of the same as per the different items of Grant Agreement cannot be carried over. Also depreciation on this assets are not provided which is not in compliance with para 6.3.1 of FMH.

**Implication**

As per para 6.2 of FMH the EIAs will maintain a separate 'Project Account', in their existing accounting system, to record the funds received (grant and EIA share) and expenditure incurred under the sub project. To facilitate this, EIA should create appropriate account heads to record the transactions Component/ Sub-Component wise, activity-wise, sub -activity-wise based on the grant approval conveyed, irrespective of whether the EIA is handling projects other than NDP I or exclusively engaged in the approved subproject.

As per para 6.3.1 of FMH Grant-in-aid received for acquisition of capital assets should be credited under the head 'Capital Grant-in-Aid received from GOI through PMU in NDDB for the sub project' and be shown in the liability side and the corresponding assets acquired should be shown on the asset side of the Balance Sheet. Such Grant-in-aid should be allocated to the Profit & Loss Account over the periods and in the proportions in which depreciation on those assets is charged (by crediting depreciation in the Assets Account and debiting depreciation to the Profit & Loss Account. Consequently, the amount of depreciation will be debited to the Capital Grant in- Aid Account and credited to the Profit & Loss Account under the head 'Grant-in-Aid').

No such accounting treatment is followed by EIA for the purpose of ensuring compliance with guidelines, there may be cases where expenditure gets reported in inappropriate accounting period thereby leading to misstatement in PFS prepared by PMU.

**Recommendation**

We recommend that the EIA should maintain separate books of account for each project in order to segregate the capital and revenue expenditure as per the Grant agreement. PMU should give proper guidance and direction to EIA for making correct accounting treatment as required by FMH.

**Management Response**
3. Inadequate Management Committee Meeting and minutes

**Observation:**

As per Para 11.1 of the Finance Management Handbook, the management committee meeting of EIA should be held once in every 3 months to review the progress of the Project. However, we observed the EIA has not maintained the minutes of management committee meetings as per the requirements of FMH. So it might be possible that meeting has not taken place during the year.

**Implications:**

Not conducting meeting can lead to delayed implementation of the issues faced by the agencies for the purpose of achieving the objectives of sub-project and to non-compliance of FM Handbook. Also, PMU may not be aware about the problems faced by EIA in implementing the sub-project since management committee is infrequent in meeting at regular interval.

**Recommendation:**

Discussion of the affairs of the projects, recommendations / suggestion and implementation of it at regular interval is very critical for the purpose of achieving the objective of NDP - I. Also, meeting of management committee of organisation at regular interval is quite essential to give direction to any organisation. We recommend that the management committee of EIA should meet once in every 3 months to review the progress of the Project as per FM Handbook guidelines and maintain the minutes of the same.

**Management Response:**
National Dairy Plan – Phase I
Indore Milk Union

4. **Physical verification of capital assets acquired under sub-project**

*Observation:*

We observed that the physical verification of assets created under sub-projects was not performed by internal auditors of EIA during the year ended on March 31, 2016 as required by Para 6.3.3 of FMH and Para 9.5.4 of Project Implementation Plan (PIP). In absence of physical verification process, no reconciliation of existence assets with the accounting records is carried out.

*Implication:*

Capital expenditure is one of the major elements in implementation of Project and benefits of the project can be achieved over a period of time by guidelines/framework as prescribed for implementation of project. Project will be implemented through the assets acquired for project and appropriate and timely use of it will yield the results for implementation of project. Also, it is one of the requirements that project funds get utilized in accordance with the condition of the agreement. In case of non-adherence, there will be breach of the agreement.

In absence of timely physical verification/tagging procedure, there may be cases where damage/pilferage or idle usages of assets get unnoticed or there are chances of assets becoming untraceable over a period of time. In turn, benefits of project implementation will not yield any results i.e. productivity enhancement or expansion of village based milk procurement system.

*Recommendations:*

- Compliance with FMH ensures efficient compliance of accounting and internal control systems, timely alarm of financial problems, establishment of accountability and responsibility, compliance of applicable governing rules and laws, proper forecasting and budgeting and establishment of internal control system including internal audit:
  - Only with the Physical verification of capital assets at regular interval and appropriate identification and tagging of the capital assets, it can be traced in future. Considering the project will get implemented over a period of time, it is utmost important to have physical verification and tagging.
  - It is a requirement of para 9.5.4 of Project Implementation Plan to have the physical verification carried out by the Internal auditors once in every year.
  - Physical verification of fixed assets is an important procedure which assures existence and active usage of assets acquired under NDP I and is even specifically mentioned in FMH.
- We suggest that EIAs should adequately adhere to the guidelines set under FMH for physical verification of assets acquired and keep appropriate records of such verification. PMU shall insist upon the internal auditors report on project assets at regular interval i.e. once in a year where there are substantial capital expenditure and if physical verification of assets is not included in Internal Auditors’ report then it shall be included in their scope.
Management Response:
5. Internal Auditors' findings and action taken by management

Observation:

We observed that the EIA has a pre-payment audit process which is carried out by internal audit department at EIA. They verify all relevant documents for expenditure towards sub-project and initial the voucher before payment to vendor is approved by Accounts Department. However, Internal auditors don't issue any audit report containing their audit findings/observations or recommendation for the work carried out by them. Report for pre-payment audit carried out by internal auditors will help the management to understand the findings during such audit. Currently, EIA has implemented pre-payment audit process and has no post-payment audit process in place for audit of sub-project transactions and books of accounts. Pre-payment audit processes focus upon the aspects different from post-payment audit aspects. Also, Audit of post-payment internal audit brings out the weaknesses/deficiencies in the existing control environment and throws light upon the management to improve such identified areas.

Implication:

Absence of system for issue of audit report for findings by the internal auditors during pre-payment audit can leave out the significant gap in the areas for improvement in processes/action plans by the management. Also, the management/governing committee will not able to get any observations from them and will not able to provide any suggestion/action plans in a timely manner which helps in efficient and effective implementation of sub-project.

Absence of post-payment internal audit function within Organization leads to heightened risk of control lapses, override of controls, fraud etc. remaining unnoticed and increases the chances of continuing of errors repeatedly. Also, it doesn't give any insights to the EIA to improve their control system.

Recommendation:

We understand the internal control set-up at EIA; however we recommend that the Internal Auditors should issue a report indicating their findings during the course of audit carried out by them. Such report will be helpful to management, external parties etc. to understand the findings of them and actions taken by the management to ensure the implementation of better controls/actions to avoid continuity of such lapses. It will give an opportunity to the management to work upon weakness/control lapses in particular areas of organisation. Such points can also be raised to PMU for their review and their recommendations, which will help the PMU team in reviewing the internal auditor's observations and management action plan. Further, the EIA should include in the scope of pre-audit that the expenditure should be as per the limits of the SPP.

Management Response: