

# Financial Management Assessment

Project Number: 49108-002  
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September 2017

India: Himachal Pradesh Skills Development Project

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## CURRENCY EQUIVALENTS

(as of 4 September 2017)

Currency unit	-	Indian rupee/s (₹)
₹1.00	=	\$0.01567
\$1.00	=	₹63.8100

## ABBREVIATIONS

ADB	-	Asian Development Bank
APFS	-	audited project financial statements
CAAA	-	Controller of Aid, Accounts, and Audit
CAG	-	Comptroller and Auditor General of India
DEA	-	Department of Economic Affairs
DOHE	-	Department of Higher Education
DOP	-	Department of Planning
DOTe	-	Department of Technical Education, Vocational and Industrial Training
EAP	-	externally aided project
FMA	-	financial management assessment
HPKVN	-	Himachal Pradesh Kaushal Vikas Nigam
HPSDP	-	Himachal Pradesh Skills Development Project
HPSAS	-	Himachal Pradesh Subordinate Accounts Service
ITI	-	industrial training institute
LAD	-	Local Audit Department
MIS	-	management information system
NSDC	-	National Skill Development Corporation
PFM	-	public financial management
PIU	-	project implementing unit
PMC	-	project management consultant
PMU	-	project management unit
PWD	-	Public Works Department
TVET	-	technical and vocational education and training



## I. INTRODUCTION

1. At the request of the Government of India and the Himachal Pradesh government, the Asian Development Bank (ADB) will provide \$80 million in loan assistance to reinforce the efforts of Himachal Pradesh in modernizing and reforming its technical and vocational education and training (TVET) institutions, and scaling up training capacity. The proposed Himachal Pradesh Skills Development Project (HPSDP) will assist the state in improving the employment and livelihood development opportunities for its youth by improving the reach, quality, and effectiveness of its TVET programs. The outcome will be improved employment and livelihood development opportunities for those trained under the project. This will be achieved through the following outputs:

- (i) Output 1: TVET in Himachal Pradesh improved and aligned to national standards.
- (ii) Output 2: Market-aligned skills ecosystem created.
- (iii) Output 3: Access to quality training institutes improved.
- (iv) Output 4. TVET institutional structure improved.

2. The Department of Planning (DOP) of Himachal Pradesh will be the executing agency for the proposed project.<sup>1</sup> The Himachal Pradesh Kaushal Vikas Nigam (HPKVN); the Department of Technical Education, Vocational and Industrial Training (DOTE); Department of Higher Education (DOHE); and the Public Works Department (PWD) will be the implementing agencies. All vocational training activities to be funded through private sector training service providers will be managed by HPKVN. PWD will be fully responsible for the procurement and supervision of all civil works, i.e., construction of the training facilities and purchase of the required furniture. DOTE will procure the upgraded training equipment for the selected industrial training institutes (ITIs). To facilitate coordination, the procurement and management of all the consulting firms and training service providers (for handling different types of vocational training and livelihood development programs) will be managed by HPKVN. Other than to PWD, which will operate a treasury account, all funds will also flow through HPKVN.

3. Since the successful planning and execution of TVET programs requires coordination across multiple departments, the departments of Economics and Statistics; Industries; Labor and Employment; Urban Development; Rural Development; and Social Justice and Empowerment will function as support departments. These departments will assist implementing agencies as noted in the Project Administration Manual, and not handle any funds directly.<sup>2</sup>

4. The Himachal Pradesh government established HPKVN as a not-for-profit company under section 8 of the Companies Act, 2013 under the DOP to take the lead in delivering the mandate of the Himachal Pradesh Skills Development Mission by bringing about convergence across the TVET programs being run by different departments, and aligning all training with the competency levels specified in India's National Skills Qualification Framework and other national quality assurance and certification norms. HPKVN was formally incorporated on 14 September 2015 with an initial authorized share capital of ₹10 million and paid up capital of ₹70,000.

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<sup>1</sup> The minister-in-charge of the Department of Planning is the chief minister of the state. Since Himachal Pradesh is a small state, the chief minister heads both planning and finance departments. The additional chief secretary and principal secretary are also the same person for both the planning and finance departments.

<sup>2</sup> Project Administration Manual (accessible from the list of linked documents in Appendix 2 of the main text).

5. The chief minister is the chairman of the board of directors of HPKVN with ministers of four departments as members. Other members of the board include the chief secretary, additional chief secretaries or principal secretaries of five departments, representatives of industry associations and public, and the managing director of KPKVN. The managing director was appointed in the first board of directors' meeting and has taken charge effective 14 September 2015. In the third meeting of the board of directors held on 31 December 2016, the audited accounts for the fiscal year (FY) 2016 were approved. There is strong government commitment evidenced by the leadership in the board of HPKVN. A budget head has been opened under DOP for providing funds to HPKVN. In FY2016, ₹50 million was allocated out of which ₹10 million was released. In FY2017, ₹50 million has been allocated and ₹25 million has been released until December 2016. The corporate structure will promote autonomy and flexibility in operations. The board of directors has already sanctioned the appointment of external auditors and internal auditors for HPKVN.

6. To ensure the smooth implementation of the HPSDP, a project management unit (PMU) has already been established at HPKVN. It comprises the managing director of HPKVN as project director, two general managers, and other officers to oversee key functions such as (i) coordination with other implementing agencies and line departments; (ii) managing accounts, audit, procurement; (iii) engagement and supervision of training service providers, assessment agencies, and consulting firms; (iv) project reporting through the management information system (MIS); and (v) facilitating industry engagement, internships, and placements. In addition to being responsible for running their own short-term vocational training programs and forging strong links with industry partners, the PMU will coordinate with the other implementing agencies.

7. Project implementation units (PIUs) have been established at each of the three implementing agencies to undertake project activities. They include the director of the relevant implementing agency and other officers to handle finance and accounts, procurement, or any other function as required for smooth implementation.

## II. EXECUTIVE SUMMARY

8. A financial management assessment (FMA) was conducted in May–August 2016 in accordance with ADB's Financial Management Assessment Technical Guidance Note, 2015 and ADB's Financial Due Diligence: A Methodology Note and updated in January 2017.<sup>3</sup> The FMA was conducted for HPKVN, a newly established company, to determine the minimum institutional arrangements and control measures required to implement the project, and to ensure that funds are used for their intended purposes. The FMA also covers the other implementing agencies, namely, DOHE, DOTE, and PWD, to determine whether adequate financial management arrangements are in place in these departments. A procurement assessment has been carried out separately.<sup>4</sup>

9. The FMA focuses on fund flows, budgeting, staffing, accounting policies and procedures, internal controls, financial reporting and monitoring, and internal and external audit. It draws on the experience gained from ongoing ADB skill development projects in India in the states of Meghalaya<sup>5</sup> and Kerala<sup>6</sup>, and relevant findings from the report of the

<sup>3</sup> ADB. 2015. *Financial Management Assessment Technical Guidance Note*. Manila; ADB. 2009 *Financial Due Diligence: A Methodology Note*. Manila.

<sup>4</sup> Procurement Capacity Assessment (accessible from the list of linked documents in Appendix 2 of the main text).

<sup>5</sup> ADB. 2013. *Report and Recommendation of the President to the Board of Directors: Proposed Loan and Administration of Technical Assistance Grant to the Government of India for Supporting Human Capital Development in Meghalaya*. Manila

comptroller and auditor general of India on the functioning of the training service providers of the National Skill Development Corporation (NSDC).<sup>7</sup> These reference documents provide lessons learned from projects implemented by NSDC and identify areas for strengthening financial management and overall sector practices. FMA questionnaires take into account the responses by HPKVN, DOHE, DOTE, and PWD as well as recent ADB country and sector-level experience. The FMA questionnaires are available on request.

10. Key risks pertain to the recently established HPKVN. The financial management risk is considered moderate. However, with the proposed risk mitigating measures, it is expected that HPKVN's financial management capacity will be strengthened adequately. A number of actions have already been taken. The overall assessment of the project's financial management risks and internal control risk assessment are presented in Table 1.

**Table 1: Financial Management and Internal Control Risk Assessment for the Himachal Pradesh Skills Development Project**

Risk	Pre-mitigation Risk Rating	Mitigation Measures
<p><b>Country-specific</b></p> <p>Overall, somewhat weak country PFM system with regard to policy-based budgeting (especially the lack of a multiyear perspective), tax administration, control in budget execution, internal audit, as well as timeliness of external audits and follow-up on audit findings.<sup>a</sup></p>	Moderate	<p>Implementation of PFM reforms in line with the recommendations of the Second Administrative Reform Commission, Government of India.<sup>b</sup> However, as skill development in Himachal Pradesh will be implemented through the corporatized HPKVN in mission mode ("mission mode" is a term used in India to describe an undertaking by the government assigning a group of dedicated people within a time-bound action plan), adequate financial allocation is expected, along with internal control measures such as internal audit and timely resolution of audit issues.</p>
<p><b>Executing and/or implementing agencies</b></p> <p><b>HPKVN</b></p> <p>HPKVN was formally established in September 2015 as a 100% government-owned company under the Department of Planning, Government of Himachal Pradesh. It therefore, follows the Himachal Pradesh financial rules and is subject to external audit. While basic financial management and accounting systems have already been set up,</p>	Moderate	<p><b>All implementing agencies</b></p> <p>A financial management consultant, an accountant, and a procurement consultant will be fielded under the PMC firm to be engaged under the loan. These consultants will continue to support all implementing agencies including HPKVN in executing financial management and other</p>

<sup>6</sup> ADB. 2014. *Report and Recommendation of the President to the Board of Directors: Proposed Results-Based Loan and Administration of Technical Assistance Grant to the Government of India for Supporting Kerala's Additional Skill Acquisition Program in Post-Basic Education*. Manila.

<sup>7</sup> Union Government Ministry of Finance and Ministry of Skill Development and Entrepreneurship. 2015. Compliance Audit on National Skill Development Fund and National Skill Development Corporation for the Year Ended March 2014. *Report No. 45 of 2015*. New Delhi. <http://www.cag.gov.in/content/report-no-45-2015-compliance-audit-national-skill-development-fund-and-national-skill>

<b>Risk</b>	<b>Pre-mitigation Risk Rating</b>	<b>Mitigation Measures</b>
<p>they will have to be strengthened progressively as project activities, especially training programs, are scaled up.</p> <p>HPKVN already has 27 full-time staff including a managing director, two general managers, and other staff responsible for critical functions such as financial management, accounts, procurement, administration, training, mobilization, and industry outreach.</p> <p>A full-time chartered accountant has been appointed by HPKVN effective June 2016. A part-time company secretary was also hired in January 2017 to attend to compliance issues of HPKVN.</p> <p>HPKVN has already engaged an internal auditor and a statutory auditor. The statutory audit for FY2016 has been completed and the audit report was approved by the Board of Directors on 31 December 2016. The internal audit report for FY2016 has also been prepared. There were no adverse findings.</p> <p>Significant efforts have already been made during project design to establish a strong institutional foundation, lay down the required business processes and familiarize the implementing agencies with ADBs financial management procedures.</p> <p><b>DOP, DOHE, DOTE, and PWD</b></p> <p>HPKVN has been coordinating well with the other implementing agencies</p> <p>The Himachal Pradesh government has significant experience of handling donor-funded projects. Officers of the DOP (the executing agency for HPSPD), along with PWD and DOTE (two of the implementing agencies), have worked on a number of projects and are therefore familiar with ADB's financial management and other fiduciary requirements.</p>		<p>fiduciary functions in an effective manner.</p>
<p><b>Funds flow and budgeting arrangements</b></p> <p>The PMU shall be housed within HPKVN. The DOP will channel all project funds to the various implementing agencies (DOTE, DOHE, and PWD) through HPKVN.</p> <p>A budget head has already been opened under DOP for providing funds to HPKVN. In FY2016,</p>	<p>Low</p>	<p>To ensure smooth funds flow, the following additional measures will be taken:</p> <p>(i) HPKVN and other implementing agencies (excluding PWD) will open separate bank accounts in a commercial bank for the</p>



<b>Risk</b>	<b>Pre-mitigation Risk Rating</b>	<b>Mitigation Measures</b>
<p>₹50 million was allocated out of which ₹10 million was released. In FY2017, ₹50 million has been allocated and ₹25 million has been released till December 2016.</p>		<p>project prior to loan effectiveness. PWD will operate through its treasury bank account.</p> <p>(ii) Adequate budget will be allocated for all planned activities annually.</p> <p>(iii) DOP will disburse funds to HPKVN for the project on a quarterly basis based on actual fund requirements, after deducting the opening balance. HPKVN will also follow a similar system for disbursing funds to the other implementing agencies. This will ensure that funds are not blocked at the level of implementing agencies.</p>
<p><b>Staffing</b></p> <p><b>HPKVN</b></p> <p>The General Manager Finance reports to the Managing Director and looks after the accounts, finance, and compliance-related matters of HPKVN. In addition, there are experienced full-time officers in HPKVN to handle finance, accounts, and administrative issues</p> <p>The state-level project steering committee and project management implementation committee have been established.</p> <p><b>DOHE, DOTE, and PWD</b></p> <p>The Directors of each of the implementing agencies (DOTE, DOHE) and the Engineer-in-Chief of PWD head their respective PIUs. They are being supported by their respective finance, accounts, and procurement staff in executing project activities.</p>	Moderate	<p><b>HPKVN</b></p> <p>The PMC firm to be engaged under the loan will have a Financial Management specialist, an Accounts Officer, and a Procurement Specialist. These consultants will assist HPKVN and other implementing agencies.</p> <p><b>DOHE, DOTE, and PWD</b></p> <p>All implementing agencies will appoint or assign project-specific staff.</p>
<p><b>Accounting policies and procedures</b></p> <p><b>HPKVN</b></p> <p>HPKVN shall follow the accounting processes laid down in Himachal Pradesh's Financial Rules, 2009, as applicable to a government-owned entity. It will also comply with the requirements under the Companies Act, 2013. This requires accrual-based accounting, which allows for extraction of cash basis accounts, to facilitate consolidation with the</p>	Moderate	<p><b>HPKVN</b></p> <p>A comprehensive finance and accounting manual shall be prepared and submitted to the board for approval by November 2017.</p> <p><b>DOP, DOHE, DOTE, and PWD</b></p> <p>Implementing agencies will</p>

<b>Risk</b>	<b>Pre-mitigation Risk Rating</b>	<b>Mitigation Measures</b>
<p>accounts of the other implementing agencies which are government departments. Accounting policies have been drafted and approved by the Board of Directors as a part of the first financial statements on 31 December 2016.</p> <p><b>DOP, DOHE, DOTE, and PWD</b></p> <p>Relevant staff of these departments should receive training on ADB's project accounting policies and procedures.</p>		<p>maintain detailed project-related records for preparing consolidated project financial statements.</p> <p>Relevant staff of HPKVN and the implementing agencies will be invited to the periodic financial management and disbursement workshops organized by ADB's India Resident Mission.</p>
<p><b>Internal Controls</b></p> <p><b>HPKVN</b> Accounting policies have been drafted and approved by the Board as a part of the first financial statements on 31 December 2016.</p> <p>HPKVN shall follow the Himachal Pradesh Financial Rules, 2009 as applicable to a government-owned entity.</p> <p><b>DOHE, DOTE, and PWD</b></p> <p>Other implementing agencies follow established Himachal Pradesh financial rules for delegation of authority levels, segregation of duties, controls over bank balances, etc. Himachal Pradesh has also implemented e-payment systems with its own internal control systems.</p>	Low	<p><b>HPKVN</b></p> <p>A comprehensive finance and accounting manual shall be prepared and submitted to the Board for approval by November 2017.</p> <p><b>DOHE, DOTE, and PWD</b></p> <p>Not applicable.</p>
<p><b>Internal audit</b></p> <p><b>HPKVN</b></p> <p>Since HPKVN is a new entity, the internal audit function has been initially outsourced. Based on the terms of reference provided by ADB, internal auditors Mukesh K. Sharma &amp; Associates were appointed by HPKVN for FY2016. They have submitted their first internal audit report with no major findings. Jitender Manoj &amp; Associates, Chartered Accountants, have been appointed as internal auditor for FY2017.</p> <p><b>DOP, DOHE, DOTE, and PWD</b></p> <p>Currently, there is very limited internal audit function at the state level in Himachal Pradesh. None exists at the implementing agencies level.</p>	Moderate	<p><b>HPKVN and other implementing agencies</b></p> <p>The outsourced internal auditors will perform the internal audit of HPKN in accordance with the terms of reference provided by ADB aligned to internal best practice.</p> <p>The scope of internal audit shall include all project activities undertaken by HPKVN and the other implementing agencies under the ADB project.</p>
<p><b>External Audit</b></p> <p><b>HPKVN</b></p>	Low	<p><b>HPKVN</b></p> <p>Statutory auditors will continue to be sensitized on the requirements for the ADB project financial</p>

<b>Risk</b>	<b>Pre-mitigation Risk Rating</b>	<b>Mitigation Measures</b>
<p>Statutory auditors Vijay Kumar Sharma &amp; Associates; Chartered Accountants; and Nadaun (Hamirpur, Himachal Pradesh) were nominated by CAG and appointed by the HPKVN Board of Directors for FY2016. They issued their unqualified audit report for FY2016 dated 10 October 2016, which was within the timeline required under the Companies Act, 2013. The CAG also provided their supplementary audit opinion with no additional findings. The HPKVN Board of Directors has appointed Mukesh K Sharma &amp; Associates, Shimla; and Chartered Accountants, as statutory auditors for FY2018.</p>		<p>statements</p> <p>The Auditor General, Government of Himachal Pradesh, may also undertake supplementary audit.</p> <p><b>DOP, DOHE, DOTE, and PWD</b></p> <p>The chartered accountant firm appointed for HPKVN shall also undertake audit of the ADB project at the implementing agencies.</p>
<p><b>Reporting and monitoring</b></p> <p><b>HPKVN</b></p> <p>A financial accounting and reporting system, which can also monitor key results, is yet to be established.</p> <p><b>DOP, DOHE, DOTE, and PWD</b></p> <p>The implementing agencies have their own reporting and monitoring systems in place to cover their own activities. However, these reporting and monitoring systems will have to cover project activities and requirements.</p>	Substantial	<p><b>HPKVN and other implementing agencies</b></p> <p>HPKVN and other implementing agencies will design and implement a robust computerized financial accounting, reporting, and monitoring system so that financial and physical program reports can be generated online.</p>
<p><b>Information systems</b></p> <p>HPKVN does not have any information system in place as it is a new entity. Other implementing agencies (line departments) have some form of information systems. However, they cover their own respective activities, and are not integrated at the state level.</p>	Substantial	<p>HPKVN shall operationalize a basic off-the-shelf accounting software at HPKVN.</p> <p>This will subsequently be merged with the comprehensive MIS for financial reporting.</p>
<b>Overall Risk</b>	<b>Moderate</b>	

ADB = Asian Development Bank; CAG = comptroller and accountant general of India; DOHE = Department of Higher Education; DOP = Department of Planning; DOTE = Department of Technical Education, Vocational and Industrial Training; FY = fiscal year; HPKVN = Himachal Pradesh Kaushal Vikas Nigam; MIS = management information system; PFM = public financial management; PMC = project management consultant; PMU = project management unit; PWD = Public Works Department.

<sup>a</sup> ADB. 2012. *Risk Assessment and Risk Management Plan (Summary)*. Manila; ADB. Forthcoming. *Country Partnership Strategy: India, 2018–2022—Accelerating Inclusive Economic Transformation*. Manila.

<sup>b</sup> Government of India, Second Administrative Reforms Commission. 2009. *14th Report Strengthening Financial Management Systems*. New Delhi. <http://arc.gov.in/14threport.pdf>

<sup>c</sup> An ADB financial management consultant has been working with HPKVN and other implementing agencies since January 2016 to familiarize them with ADB's financial management protocols, and how to comply.

Source: Asian Development Bank.

11. The action plan for financial management-related activities is presented in Table 2.

**Table 2: Financial Management Action Plan for Himachal Pradesh Skill Development Project**

S. No.	Description	Timeline	Responsibility
1	Ensure adequate budget allocation	Before loan effectiveness and annually	DOP has already allocated budget and disbursed funds to HPKVN for FY2017.
2	Install and operationalize an off-the-shelf accounting software at HPKVN and other implementing agencies. Subsequently, the accounting software may be integrated with the project MIS for financial reporting	By June 2017	HPKVN and other implementing agencies.
3	Open separate project bank accounts at HPKVN and other implementing agencies (other than PWD), with all bank accounts to be jointly operated	After loan effectiveness	All implementing agencies (excluding PWD, which will operate through the treasury bank account).
4	HPKVN and implementing agencies will prepare quarterly physical and financial targets for the project.  The proposed flow of funds from DOP to HPKVN to the implementing agencies will be on a quarterly basis based on expected targets	Ongoing on a quarterly basis	All implementing agencies
5	HPKVN shall disclose all project-related, including financial statements and procurement related information, on a dedicated website to be updated regularly	Ongoing during project implementation	HPKVN
6	Conduct training in ADB's procurement, financial management and disbursement procedures	Ongoing	ADB

ADB = Asian Development Bank, DOP = Department of Planning, FY = fiscal year, HPKVN = Himachal Pradesh Kaushal Vikas Nigam, MIS = management information system, PMU = project management unit, PSC = project steering committee, PWD = Public Works Department.

Source: Asian Development Bank.

12. HPKVN and other implementing agencies shall implement the project as per relevant policies and procedures of the Himachal Pradesh government and ADB.

### III. COUNTRY AND SECTOR ISSUES

13. Using existing diagnostics and available reviews, this section provides a country-level financial management assessment focusing on the overall public financial management (PFM) set-up of the Government of India, and its functioning vis-à-vis public expenditure management outcomes, taking into account the state-level issues as and where possible based on available information.

14. The scores of the individual performance indicators at the Government of India level in the 2010 Public Expenditure Framework Assessment have been computed to provide the averages for the six high-level PFM dimensions as well as the overall score (Table 3).<sup>8</sup>

**Table 3: Government of India Public Expenditure Framework Assessment-Based Public Financial Management Performance Assessment, 2010**

Public Financial Management Performance Dimension		Calculated Ratings	
		Numerical Scores	Equivalent PEFA Ratings
A	Credibility of the budget	2.67	B
B	Comprehensiveness and transparency	3.58	A
C	Policy-based budgeting	1.75	C
D	Predictability and control in budget execution	2.44	C+
E	Accounting, recording, and reporting	3.00	B
F	External scrutiny and audit	2.33	C
<b>Calculated Overall Score</b>		<b>2.75</b>	<b>B</b>

PEFA = public expenditure framework assessment.

Note: The calculations are based on A = 4, B+ = 3.5, B = 3, C+ = 2.5, C = 2, D+ = 1.5 and D = 1, which is the generally applied approach for quantifying PEFA scores.

Source: PEFA. 2010. *Public Expenditure Framework Assessment for India*. Delhi.

15. The PFM dimension with the highest score is “comprehensiveness and transparency,” while the lowest is for “policy-based budgeting.” Also, the dimensions “predictability and control in budget execution”; “accounting, recording and reporting”; and “external scrutiny and audit” all have relatively high scores.

16. Himachal Pradesh has also been assessed by the World Bank via its Public Financial Management Accountability Assessment in June 2009.<sup>9</sup> Although the report is dated, it continues to be generally relevant at present. Of the 31 indicators for assessment, 10 have been assessed as C (opportunities for some improvement) and D (in need of improvement in some areas). The major issues identified in the report are as follows:

- (i) With respect to aggregate fiscal discipline, the overall budget turnout is affected by spending in excess of budget intentions.
- (ii) Overall liabilities for the government are additionally affected where fiscal risks in state-owned enterprises and other government departments are not monitored well.
- (iii) Owing to relatively weak performance in the expenditure controls and scrutiny processes, checks and balances in the PFM system are prevented from working effectively to ensure that the budget is implemented as intended.
- (iv) Efficient service delivery is affected due to the lack of modern, open, competitive procurement procedures; control weaknesses; lack of strategic focus on internal audit; and slow response to external audit scrutiny. These reduce the extent to which managers can be held accountable for efficient and rule-based management of resources to deliver services.
- (v) Expenditures of a contractual nature, e.g., salaries, pensions, and interest dominate the overall expenditure of the Himachal Pradesh government. This is likely to have significant impact on the efficiency of resources used at the service delivery level.

<sup>8</sup> Public Expenditure and Financial Accountability. 2010. *Assessment and Data Reports*. Washington DC. <https://pefa.org/assessment/mar10-pfmpr-public-en>

<sup>9</sup> World Bank. 2009. *India–Himachal Pradesh, Public Financial Management Accountability Assessment*. World Bank Report. No. 48635-IN. Washington, DC.

17. Himachal Pradesh has taken note of the points mentioned in the World Bank's report. One of the most important improvements was the revision of the Himachal Pradesh Financial Rules, 1971 in 2009. Processes for budgetary control and allocation of resources for service delivery were also improved. These are regularly monitored now to avoid any expenditure over the budgeted amount and ensure timely availability of resources to the respective department.

#### IV. DETAILED FINANCIAL MANAGEMENT ASSESSMENT

##### A. Overview of the Executing Agency and Implementing Agencies, Financial Management System and Institutional Context

18. The Himachal Pradesh government established the Himachal Pradesh Skill Development Mission on 6 June 2009. The mission is headed by the chief secretary as the chairman, and consists of the additional chief secretary or principal secretary of 16 departments, engineer-in-chief of Public Works Department and Public Health Department, with the advisor (planning) as member secretary.<sup>10</sup> The mission held several meetings to review and implement skill development activities in the state.<sup>11</sup>

19. The government also established a State Skill Upgradation Council in 2012 with the objective of upgrading skill development in the state. This council is also headed by the chief secretary as chairman, and has additional chief secretary or principal secretary of 16 departments (footnote 5) as members, with the advisor (planning) as member secretary. However, since 2012, no meetings have taken place in this council.

20. The government established the Himachal Pradesh Skill Development Society in January 2014. However, this has now been replaced by HPKVN, which was established under DOP as a company under section 8 of the Companies Act, 2013. HPKVN was formally incorporated on 13 September 2015. The chief minister of Himachal Pradesh is the chairman of the board of directors with ministers of four departments as members.<sup>12</sup> Other members are chief secretary, additional chief secretary or principal secretary of five departments;<sup>13</sup> representatives of sectors, industry associations, and institutes; representatives from the public; and the managing director. The managing director was appointed and he has taken charge since the first board meeting held in December 2015. His initial activities included activities related to incorporation of the company, setting up infrastructure, and providing clarity to the proposed activities.

21. The overarching aim of the company, in the medium to long term, is to ensure synergies in skill development across departments. HPKVN will also be playing a more active role in policy-making and implementation of skill-related reforms. HPSDP will build the capacity of HPKVN to undertake the following activities:

- (i) evaluate the performance of past and ongoing vocational programs to draw lessons;

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<sup>10</sup> Department of Agriculture, Department of Animal Husbandry, Department of Education, Department of Energy, Department of Finance, Department of Health and Family Welfare, Department of Horticulture, Department of Industries, Department of Information Technology, Department of Labor and Employment, Department of Rural Development, Social Justice and Empowerment, DOTE, Department of Tourism, and Department of Urban Development.

<sup>11</sup> The Himachal Pradesh Skill Development Mission has had five meetings in all (15 July 2009, 31 December 2009, 3 May 2011, 17 June 2011, and 22 August 2012).

<sup>12</sup> Department of Education, Department of Labor and Employment, DORD, DOTE; as well as *panchayati raj* institutions.

<sup>13</sup> Department of Education, Department of Labor and Employment, Department of Planning and Finance, DORD, DOTE; as well as *panchayati raj* institutions.

- (ii) undertake district-level skill-gap analysis, and identify the gaps in terms of skills training infrastructure especially in underserved districts and blocks;
- (iii) design a statewide information technology-based MIS system for tracking program activities, and supporting credible monitoring and evaluation;
- (iv) strengthen partnerships with NSDC, industry associations, and sector skills councils to improve assessment and certification standards, and to tap into internship and placement opportunities;
- (v) conduct regular monitoring and evaluation and tracer surveys to assess effectiveness of the skill development programs in terms of enhancing employability and improving employment prospects;
- (vi) harmonize procurement, financial management, and safeguards procedures for procuring and supervising the work of skills training providers, and undertaking civil works and purchase of goods and works;
- (vii) mainstream gender concerns and issues pertaining to the differently abled into the design and execution of the training programs;
- (viii) mainstream green or environmental concerns into the design and execution of the training programs; and
- (ix) strengthen program management and create a cadre of staff specializing in handling different facets of skill development work.

22. **Participation of private sector and industry experts.** HPKVN shall actively engage with the private sector and industry and/or sector experts to participate in providing skills training. Through the establishment of HPKVN as a company with a separate legal identity and with board members from the private sector, the Himachal Pradesh government has allowed HPKVN a fair degree of autonomy and independence. Private sector practitioners can apply and join the company as officers.

23. **Accounting, auditing, and budgetary system.** The Himachal Pradesh government follows India's accounting system, which is a cash-based system. The fiscal year starts 1 April and ends 31 March. The budgets are prepared and approved by the state's legislature by end of February or early March for the next fiscal year. Spending by all departments is regularly tracked by DOP so that in case of any excess or shortfall, the same can be addressed on a timely basis. This is generally done after the end of two quarters. The recommended sequencing of spending is 20%, 25%, 30%, and 25%, respectively, for the four quarters.<sup>14</sup> DOP holds quarterly progress meetings to monitor implementation of various schemes. The state government has notified the Himachal Pradesh Financial Rules, 2009, which deals with the general system of financial management in the state, budget formulation and implementation, principles of government accounts, works, procurement of goods and services, inventory management, contract management, grants-in-aid, and government guarantees and establishment, among other things.<sup>15</sup> A budget circular is issued by the Department of Finance to all departments detailing the procedure to be followed for budget estimates for the following year, and revised estimates of the current year, along with formats to be used.<sup>16</sup> Statutory audit of the state government is conducted by the accountant general's office, which represents the comptroller and accountant general of India at the state level.

<sup>14</sup> Government of Himachal Pradesh, Department of Planning. 2010. *Circular No. PLG(XI)2-1/2008-09-RE(loose). Guidelines for the Implementation and Monitoring of Annual Plan*. Shimla.

<sup>15</sup> Government of Himachal Pradesh, Department of Finance. 2014. Himachal Pradesh Financial Rules, 2009. *Circular No. Fin(C)A(3)5/2005*. 12 August. Shimla.

<sup>16</sup> Government of Himachal Pradesh, Department of Finance. 2014. Budget Circular for the Budget Estimate 2015–2016 and RE 2014–2015. *Circular No. FIN-A-C(6)-1/2014*. 14 August. Shimla.

## B. Strengths

24. The following strengths have been identified based on the FMA:

- (i) **Dedicated entity for implementation of the project.** HPKVN has been formed so that it can function with flexibility and with complete focus toward skill development in the state. Since HPKVN is a new entity, its sole program in the short- to medium-term shall be the ADB project only.
- (ii) **Computerization.** The Himachal Pradesh government has computerized all its treasuries. These are now being connected across departments. With this, there will then be an online treasury system in Himachal Pradesh.
- (iii) **Himachal Pradesh Financial Rules.** The government has updated its 2009 financial rules after taking into consideration the comments from the World Bank's Public Financial Management Study.
- (iv) **Anticorruption departments.** Himachal Pradesh has a strong Vigilance Department, Information Commissioner, and Lokayukta that takes care of anticorruption cases.<sup>17</sup>
- (v) **Convergence between all skill development activities.** HPKVN is proposed to be the single agency for all skill development-related activities across all departments in the state. This will bring convergence of all related activities and bring in economies of scale. HPKVN shall be able to do integrated monitoring and evaluation of all skill development-related activities.
- (vi) **Prior Experience in Donor-Funded Projects.** DOHE, DOTE, and PWD have experience in implementing several national programs such as the National Secondary School Mission (Rashtriya Madhyamik Shiksha Abhiyan) for revamping secondary education, in which fiduciary arrangements are aligned in part with the World Bank's policies. In addition, donor-funded projects have also been implemented by PWD and DOP including (i) Himachal Pradesh Clean Energy Transmission Investment Program,<sup>18</sup> (ii) Infrastructure Development Investment Program for Tourism<sup>19</sup> (iii) Himachal Pradesh State Roads Project (World Bank), (iv) Himachal Pradesh Watershed Management Project (World Bank), (v) Himachal Pradesh Mid-Himalayan Watershed Development Project (World Bank), (vi) Himachal Pradesh Crop Diversification Promotion Project (Japan International Cooperation Agency), (vii) Himachal Pradesh Forest Sector Reform Project (Department for International Development), and (viii) Micro Planning at Panchayat Level (GTZ).

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<sup>17</sup> Lokayukta is an anticorruption ombudsman organization appointed by respective states in India.

<sup>18</sup> ADB. 2011. *Report and Recommendation of the President to the Board of Directors: Proposed Multitranche Financing Facility and Technical Assistance Grant to India for Himachal Pradesh Clean Energy Transmission Investment Program*. Manila.

<sup>19</sup> ADB. 2010. *Report and Recommendation of the President to the Board of Directors: Proposed Multitranche Financing Facility to India for Infrastructure Development Investment Program for Tourism*. Manila.



### C. Weaknesses

25. The following weaknesses were identified as fiduciary risk in the initial assessments of systems and processes:

- (i) **Newly established entity.** While HPKVN has made good progress in terms of establishing systems and procedures for financial management and procurement, these need to be further strengthened to be able to support the enhanced projects beyond the current pilot training program for 1,000 youth.
- (ii) **Internal audit.** While the internal audit function at the state level is not mature, HPKVN's set-up for internal audit and coverage of the project will strengthen internal audit over the TVET sector as a whole.
- (iii) **Accounting and treasury management.** The existing computerized systems are working on a stand-alone basis at all GOHP treasuries. Transactions are reentered in the compilation module to prepare the state accounts on a monthly basis. This increases the risk of data integrity and leads to problems in reconciliation. Data entry should ideally be done once and should enable automatic compilation. The risk of overbudget expenditure will also be eliminated if databases are integrated and working real-time. The government is working on this integration module, and as per plan is expected during FY2017.

### D. Personnel, Accounting Policies and Procedures, Internal and External Audit

26. **Personnel.** The Himachal Pradesh government has a dedicated cadre of finance and accounts officers. They are recruited on the basis of public examinations conducted by the Himachal Pradesh Public Service Commission. The Himachal Pradesh Institute of Public Administration functions as the main training institute for these officers. Officers of this cadre are appointed to the Himachal Pradesh Subordinate Accounts Service (HPSAS). Officers of the HPSAS are appointed in various treasuries and as joint controller of finance and accounts in various departments. All personnel of HPSAS are staff of the Department of Finance. They are placed on deputation in all departments for overall oversight over functions pertaining to finance and accounts. In addition, the respective departments have staff in their own budget and accounts section to assist the joint controller of finance and accounts in discharging his functions. As per discussions with the department, they will require additional personnel for the proposed project as their existing staff is already stretched. A person with accounting background with computer knowledge will be required for the ADB project. The proposed organogram for HPKVN is given in **Appendix 1**.

27. **Accounting and payments.** All 102 treasuries in Himachal Pradesh (including 15 district treasuries) are computerized.<sup>20</sup> The program for computerizing all treasury operations has been going on since 2007. As of January 2017, about 80% of all transactions are computerized, while 20% is still manual. Manual transactions are mainly in areas that suffer from frequent power outages, especially during heavy snowfall in winter. Accounting in these treasuries is currently undertaken on a stand-alone basis. Compilation of accounts is done at the district treasury level on a monthly basis. The system of online updating of accounts by linking all the treasuries is ongoing, and is expected to be completed soon. All treasuries in Himachal Pradesh are banking treasuries. Major banks in Himachal Pradesh include the State

<sup>20</sup> Of this, 101 are physical treasuries and one is a cyber treasury meant for online receipts.

Bank of India, Punjab National Bank, State Bank of Patiala, UCO Bank, Himachal Pradesh Grameen Bank, and Himachal Pradesh Cooperative Bank. Treasuries have the following modules on which they work:

- (i) **e-Vitran.** This handles the online allotment of budget to the drawing and disbursing officers based on the detailed demand for grants. This module is currently used in all departments except PWD, Department of Irrigation and Public Health, and Department of Forest. In these three departments, the conventional system of “letter of credit” is used.
- (ii) **e-Salary.** This handles online payment of salaries to all government employees.
- (iii) **e-Pension.** This handles online payment of pension of all retired government employees.
- (iv) **e-Kosh.** This MIS module compiles more than 120 reports generated by different departments in the Himachal Pradesh government. This module is also used to transfer data of transactions to accountant general (accounts) to compile the monthly accounts of Himachal Pradesh.<sup>21</sup>
- (v) **e-NPS.** This handles online payment of pension under the new National Pension Scheme for all retired government employees.
- (vi) **Online Treasury Accounting System.** This module is planned to be rolled out soon, which will integrate all transactions on a real-time basis.

28. All payments more than ₹10,000 (or \$150) are made through real-time gross settlement, i.e., e-payment.

29. **External audit.** The supreme audit institution of India, the Comptroller and Auditor General of India, through the Accountant General’s office in Shimla, audits the accounts of the Himachal Pradesh government. The accountant general (audit) undertakes audit of all the departments, and issues an annual audit report for the state. The audit report as of FY2015<sup>22</sup> has been issued and placed before the state’s legislature. The audit report for FY2016 is under preparation, and as per the general schedule, it will be placed in the state legislature in the budget session, i.e., sometime in March 2017. Once the report is placed in the state’s legislature, it becomes available in the public domain. The auditor general’s office conducts audit based on a risk assessment for all the departments. It undertakes audit of only the high-risk departments, directorates, and schemes. Once audit fieldwork is completed, a department wide draft audit report is prepared and shared with the relevant department. Where the audit team is satisfied with clarifications from the auditee, audit points are dropped. Otherwise, they are carried to the final audit report. Audit points which have an impact exceeding a certain value, e.g., more than ₹5,000,000 are mentioned in the final audit report before the state legislature, else they remain in the department’s audit report. A detailed analysis of the audit report for the last 3 years is attached as **Appendix 2**.

30. Audit of the newly formed HPKVN shall be done by a firm of chartered accountants. The chartered accountant firm will be appointed by the comptroller and accountant general of India (CAG) from the list of empanelled chartered accountant firms that is maintained and updated by the CAG’s office at New Delhi on an annual basis. This is a general procedure for all such state government companies formed under the Companies Act, 2013. The CAG may undertake

<sup>21</sup> Along with the transactions through eKosh, hard copies of all transactions are also sent to the auditor general (accounts).

<sup>22</sup> Comptroller and Auditor General of India. *Report No. 1 of 2016—Revenue Sector Government of Himachal Pradesh*. <http://www.cag.gov.in/content/report-no-1-2016-revenue-sector-government-himachal-pradesh>

supplementary audit of the company, according to provisions of the Companies Act. CAG has appointed chartered accountant firms for HPKVN for FY2016 and FY2017. It has also issued an audit report for FY2016.

31. Detailed consultations were held with HPKVN and the other implementing agencies regarding ADB's financial management protocols. It was informed that as per ADB procedures, an audited annual project financial statement (APFS) is required, ideally within 6 months of the close of fiscal year. DOP has agreed that this was possible since they are aware of this procedure and are already providing similar statements in other ADB-funded projects in the state. For the proposed project too, providing an audited APFS within 6 months of the end of the fiscal year will be possible. This will, however, be subject to getting the APFS from the respective departments within 3 months of the end of each fiscal year. The external auditor of HPKVN shall also audit the APFS before submitting it to ADB.

32. **Internal audit.** Internal audit function at the state level is limited to preaudit of transactions for selected agencies. The need for a robust internal audit system for the proposed project was discussed with DOP and the Department of Finance. It was felt that unless strong internal control procedures are developed and implemented for the TVET sector, which involves multiple departments and stakeholders, the government will not be able to ensure effective use of funds. This would be possible by implementing a robust internal audit system in the state.

33. The Local Audit Department (LAD) is mandated to undertake preaudits and postaudits (combination of financial, compliance, and performance audits) of local funds, i.e., schemes and funds not part of the consolidated fund.<sup>23</sup> LAD is currently auditing four major and five minor schemes. It is divided into 11 field units called audit circles. The sanctioned strength of LAD is 132, from additional director to class IV staff. As of 1 January 2017, 103 people occupy these posts. A major gap is in the post of junior auditors where only 39 of the sanctioned 61 seats are filled. In preaudit, resident auditors are placed in universities, education board, marketing board, and four major market committees. Postaudit is conducted in other institutions such as urban local bodies, Temple Trust Educational Institutes, other local fund institutions, and smaller market committees. LAD and the auditor general (audit) share their respective audit programs at the start of the year to prevent overlap with the same institution in a year. LAD conducts audit of urban local bodies in collaboration and under the technical guidance of the auditor general (audit). In FY2015, 238 institutions were audited against the target of 225. LAD undertakes audit based on a well-documented Audit Code laid down in 2007.<sup>24</sup> The Audit Code lays down the guidance notes and checklists on auditing the various processes apart from the basic principles and methodology for audit.

34. LAD also audits industrial training institutes (ITIs) too. A study of the audit reports issued for ITIs shows that there is an overall improvement in the maintenance of books and accounts. There are points related to deficiency in maintenance of some registers, nonperformance of stock taking and physical verification at the end of the year, expenses without supporting documents, and idle funds not invested in short-term deposits. The Himachal Pradesh government should build the capacity of ITIs in handling overall finance and accounts and improve the quality of book keeping. A detailed ITI-wise compilation of important points raised in LAD audits is given in **Appendix 3**.

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<sup>23</sup> Local bodies, universities, board of school education, temple trusts, academies etc. [http://admis.hp.nic.in/himachal/local audit/](http://admis.hp.nic.in/himachal/local%20audit/)

<sup>24</sup> Government of Himachal Pradesh. *2007 State Audit Code*. Shimla.

35. HPKVN has outsourced the internal audit function to an independent firm of chartered accountants appointed by the board of directors. The internal audit will be conducted on a continuous basis with audit reports submitted to the HPKVN board of directors at least semiannually. Copies of internal audit reports will be shared with ADB. Terms of reference for the internal auditor are given in **Appendix 4**. HPKVN has already appointed internal auditors for FY2016 and FY2017. Internal audit has been conducted for FY2016 and HPKVN has prepared a compliance report dated 20 September 2016 for the same. A final audit report taking into account the compliances was issued on 24 September 2016 by the internal auditor.

36. The team also met the following departments and institutions to assess integrity risks. Details of these interactions are as follows:

- (i) **Information Commission.** The state Information Commission was set up under the Right to Information Act. The commission is headed by a chief information commissioner and an information commissioner. During the year 2012–2013, the commission disposed of 429 cases out of a total of 539 pending cases. The commission has compiled a list of observations and recommendations in its report. It is observed that many recommendations are pending implementation since the first report itself, i.e., 2007–2008. Three types of cases are decided at the Information Commission, as follows:
  - a. penalty against a particular officer or department for not providing information under Right to Information Act, or for not taking the application for information;
  - b. penalty for not appointing a public information officer or first appellate authority; and
  - c. delay in providing information to the applicant.
- (ii) **Vigilance Department.** Himachal Pradesh has a Department of State Vigilance and Anticorruption Bureau that investigates cases of corruption against state government officials. The department has a full-fledged set-up right from their own police stations to the head of department who is additional director general of police rank. Almost all officers are from the police service. Each department has its own vigilance officer. The number of trial cases has increased from 171 in 2006 to 360 in 2012.
- (iii) **Lokayukta.** Lokayukta has been functional in Himachal Pradesh since 1983. This is a one-member commission represented by a retired Supreme Court judge or retired chief justice of High Court. The Lokayukta assumes significance since it can investigate allegations of corruption against the highest public offices and pass suitable orders. He or she can also act as a deterrent body to eradicate corruption and bring transparency and accountability in the government administration. As per the 2013 report of Lokayukta, out of 85 complaints (20 as of 1 January 2013 and 65 received during the year), 51 were decided.

## **E. Financial Reporting Systems, including Use of Information Technology**

37. The state has an online MIS module named e-Kosh. This MIS module compiles more than 120 reports for the use of the state government. It is also used to transfer data of transactions to accountant general (accounts) to compile the monthly accounts of the state.

39. In addition, HPKVN shall use a basic off-the-shelf accounting package for its accounting needs in the short term. This will be supplemented subsequently by a comprehensive MIS which integrates recording and monitoring of physical outputs under the program as well as payments, accounting and financial reporting.

#### **F. Disbursement Arrangements, Funds Flow Mechanism**

38. **Flow of funds.** The proposed executing agency for the program is DOP. There are four proposed implementing agencies for the program including DOHE, DOTE, PWD, and HPKVN, which is under the administrative control of DOP. All the implementing agencies except PWD will open separate budget heads for the proposed ADB funds under their respective budget. PWD will operate through the treasury bank account. DOP will transfer funds to HPKVN through bank transfers based on the periodical requirement of funds based on planned activities and expenses. The Department of Finance will account for the receipt of ADB funds under the existing budget head 1601-02-101-03 (Grant in Aid from Central Government – Grants from State / Union Territory Schemes – Block Grants – Additional Central Assistance for Externally-Aided Projects [EAP]).

39. The loan proceeds will be disbursed in accordance with ADB's Loan Disbursement Handbook (2015, as amended from time to time), and detailed arrangements agreed upon between the government and ADB. These will be used for eligible expenditures that have been incurred and paid for by the project out of its budget allocation or its own resources. Other disbursement methods as outlined in ADB's Loan Disbursement Handbook (2015) can also be adopted, as suitable for the project. Detailed funds flow procedures are given in the PAM.

40. **Availability of funds.** It has been assured that there is no problem with respect to availability of budgetary funds in the state. Funds will be released to the respective departments as and when they are required. Budget allocation for FY2018 has already been made.

#### **G. Other Compliances**

41. **Income tax.** HPKVN should be registered as a charitable entity under section 12AA and an approved institution under section 80G of the Income Tax Act, 1961. It shall obtain a permanent account number and tax deduction account number, as per the Income Tax Act, 1961.

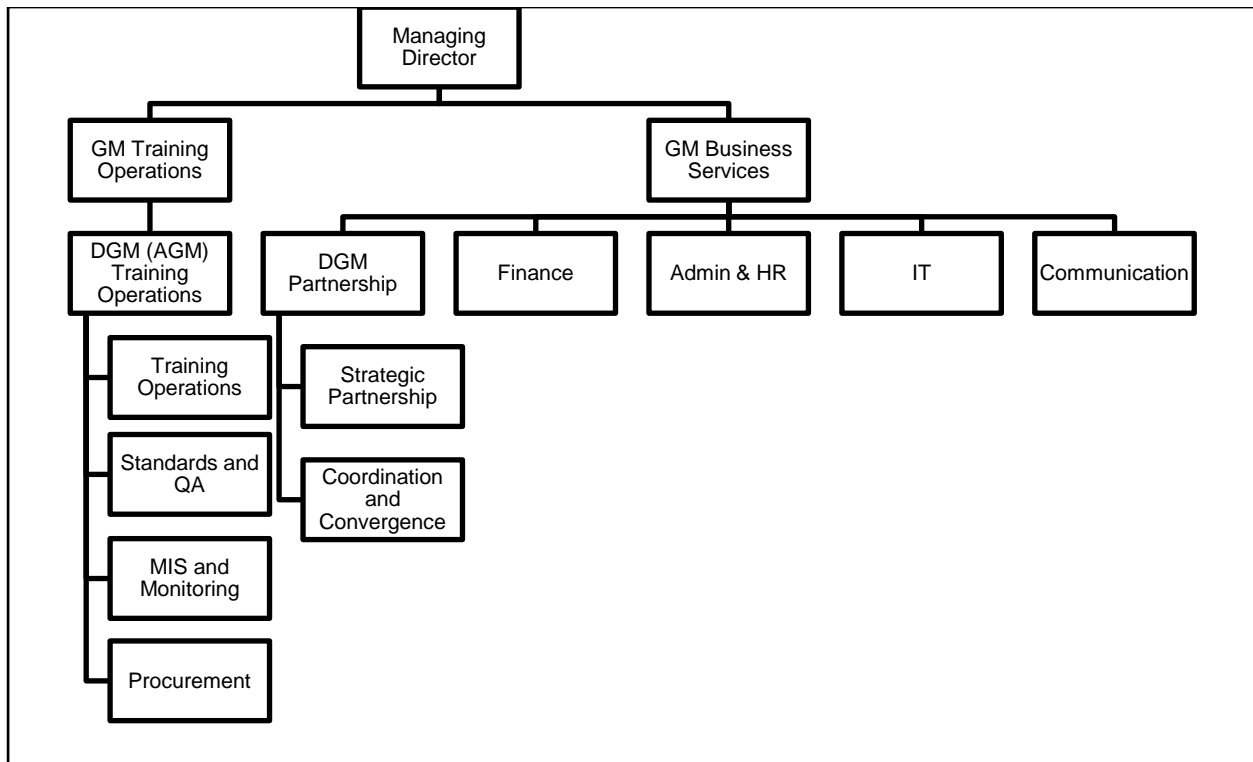
42. **Service tax.** Services provided by way of education as a part of an approved vocational education course is exempted from service tax as stated in section 66-D of the Finance Act, 1994 (commonly known as the Negative List). Services provided by a training partner approved by NSDC or a sector skills council in relation to some schemes are also exempt from service tax (as per Notification No. 25/2012-ST with effect from 20 June 2012, as amended from time to time). HPKVN is advised to take appropriate professional guidance to determine the chargeability of service tax on the courses run by them. HPKVN also needs to account for service tax on consulting or other activities that may be taken up by them.

43. **Corporate governance.** HPKVN has formed an Audit Committee in line with the terms of reference provided in **Appendix 5**. It has also appointed a vigilance officer and officials under the RIT Act.

**V. SUGGESTED COVENANTS**

44. Schedule 5 of the legal agreement shall require the implementation of the Financial Management Action Plan as stipulated in the Project Administration Manual

**APPENDIX 1  
TOP LINE ORGANIZATION STRUCTURE OF  
HIMACHAL PRADESH KAUSHAL VIKAS NIGAM**



AGM = assistant general manager, DGM = deputy general manager, GM = general manager, HR = human resource, IT = information technology, MIS = management information system QA = quality assurance.

Source: Asian Development Bank.

**APPENDIX 2**  
**REPORT OF THE COMPTROLLER AND AUDITOR GENERAL ON STATE FINANCES OF**  
**HIMACHAL PRADESH**

The Comptroller and Auditor General of India in its reports for fiscal year 2012–2014 identified the following points:

<b>Period</b>	<b>Department</b>	<b>Audit Point</b>	<b>Mitigating Measure</b>
2013–2014	DOHE, DOTE, PWD	The Government of India has transferred funds directly to the implementing agencies. Thus, these funds are out of the finance and appropriation accounts.	Funds should be routed through the state budget and not directly to implementing agencies by the central government.
2013–2014	DOHE, DOTE, PWD	Funds received by implementing agencies are parked in transitory accounts and remain unutilized for indefinite periods. This results in keeping the money out of the budgetary process and blocking of government funds.	Funds, if routed through separate accounts, should not be allowed to be unused for indefinite periods.
2013–2014	DOHE, DOTE, PWD	More than 30,000 audit paras in about 8,100 audit inspection reports involving approximately ₹187 billion (\$2.75 billion) was pending as of 31 March 2014. Audit paras as early as 1969–1970 are pending.	Time-bound action plan needs to be adopted for settling the audit paragraphs after receipt of the audit report.
2013–2014	DOP	Deputy commissioners in backward area subplans have withdrawn funds from the treasury and kept them in bank accounts. As per the Government of Himachal Pradesh's instructions (January 2004), funds should not to be withdrawn from the treasury unless required for immediate disbursement. Likewise, such funds are not to be kept in banks or post office accounts.	Funds should not be parked in bank accounts.
2013–2014	DOP	Nonmaintenance of asset registers for durable assets is in contravention of guidelines.	An asset register should be prepared and updated on an annual basis by implementing agencies under the project.
2012–2013	DOP	Unutilized funds withdrawn from the treasury have to be deposited back within the same financial year as per state government guidelines (May 2004). Implementing agencies did not deposit the unutilized balance with the treasury.	Excess funds should not be parked in bank accounts.
2011–2012	Department of Labor and Employment	No internal audit system introduced to check the internal	Introduction of an internal audit system.



<b>Period</b>	<b>Department</b>	<b>Audit Point</b>	<b>Mitigating Measure</b>
		control mechanism including its finances.	
2011–2012	Department of Technical Education, Vocational, and Industrial Training	Delay of 4–5 months in preparation of annual budget. No preparation of perspective plan and annual action plan for FY2007–2012.	Preparation of annual action plans and budget and on a timely basis.

DOHE = Department of Higher Education; DOP = Department of Planning; DOTE = Department of Technical Education, Vocational and Industrial Training; FY = fiscal year; PWD = Public Works Department.

Source: Government of India, Comptroller and Auditor General of India. New Delhi. <http://www.cag.gov.in>

**APPENDIX 3**  
**COMPILATION OF OBSERVATIONS OF LOCAL AUDIT DEPARTMENT ON AUDIT OF**  
**INDUSTRIAL TRAINING INSTITUTES**

Sl. No.	Para Ref	Observation
<b>Bilaspur Industrial Training Institute Swarnghat (Boys), FY2010–2014</b>		
1.	4(b)	All deposits are being made in a single bank account and recorded in a single cash book. There needs to be multiple bank accounts and cash books according to the nature of receipts.
2.	6	Money that was kept lying in savings bank account could have been invested in short-term deposits to earn a higher interest on idle funds
3.	7	A loan taken from ITI Bilaspur amounting to ₹1,85,000/- has not been repaid
4.	8	Vouchers against payments of ₹26,625 were not available
5.	9	Short recovery of ₹5,850 from students
6.	11	The industrial training institute did not prepare insurance for students even after receiving grant for the same
7.	12	The industrial training institute did not reconcile its bank balances with the same available in state treasuries
<b>Kangra Industrial Training Institute Palampur, FY2007–2014</b>		
1.	5	Other receipts were deposited in a fund created specifically for students' welfare
2.	7	Interest earned out of savings bank account was not recorded in the cash book amounting to ₹1,72,419/-
3.	8	Money that was kept in the savings bank account could have been invested in short-term deposits to earn a higher interest on idle funds
4.	14	Advance register was not maintained
5.	16	There is a need for an overall improvement in maintenance of books and accounts
<b>Kullu Industrial Training Institute Shamshi, FY2014</b>		
1.	7	Extra income tax deducted at source from bank deposits due to nonsubmission of permanent account number and filing of income tax returns
<b>Mandi Industrial Training Institute, FY2014</b>		
1.	5	Nonmaintenance of investment register
2.	7	Nonmaintenance of stock of receipt book, which can lead to misuse of receipt books that may not be tracked
3.	8	No stock reconciliation was undertaken for items in the stores at the end of the year
4.	10	There is a need for an overall improvement in maintenance of books and accounts
<b>Sirmour Industrial Training Institute Nahan, FY2006–2014</b>		
1.	13	Receipts from students against entry fees, tuition fees, and other receipts were deposited in the students' welfare fund instead of state treasury, which is a violation of rules.
2.	16	Students' welfare committee was not formed in the ITI, which also needs to be consulted before any spending out of the students' welfare fund.
3.	18	There is a need for an overall improvement in maintenance of books and accounts.

## **APPENDIX 4**

### **TERMS OF REFERENCE FOR INTERNAL AUDITOR**

#### **A. Introduction**

1. The Himachal Pradesh Kaushal Vikas Nigam (HPKVN) intends to procure the services of a reputable chartered accountant firm (the consultant) to provide independent and objective outsourced internal auditing for 3 years. The function of the head of internal audit, along with two assisting team members will be outsourced to the consulting firm, who will report to the board of directors. The head of internal audit is expected to be a member of the Institute of Chartered Accountants of India (ICAI) and a recognized Institute of Internal Audit, and have more than 7 years of experience in internal audit, preferably in the public sector. Internal audit team members shall have over 5 years of relevant experience. The assigned internal audit team cannot be replaced without the consent of HPKVN.

2. The internal audit function is expected to be an independent and objective assurance activity that is guided by a philosophy of adding value to improve the operations of HPKVN. It shall assist HPKVN in accomplishing its objectives by bringing a systematic and disciplined approach to evaluate and improve the effectiveness of the organization's governance, risk management, and internal control.

3. The internal audit function will cover all activities of HPKVN, as well as activities undertaken by the other implementing agencies under the Himachal Pradesh Skills Development Project. The team will set up and establish the internal audit function at HPKVN, including the development of adequate internal audit manual, such that the internal audit function may be gradually cosourced and ultimately housed within HPKVN.

#### **B. Role**

4. The purpose, authority, and responsibility of the internal audit activity must be formally defined in an internal audit charter, consistent with the Definition of Internal Auditing, the Code of Ethics, and acceptable internal audit standards. This will also give due regard to the guidance provided by the Internal Audit Division of the Comptroller General of Accounts, India. This must be approved by the board of directors of HPKVN.

5. To ensure operational independence, the internal audit head shall be appointed by and report directly to the board of directors of HPKVN.

6. In addition to the above, with respect to internal audit, the board of directors directly, or a subcommittee appointed on their behalf, shall have authority in the following:

- (i) approve the annual audit plan and all major changes to the plan, and review the internal audit activity's performance relative to its plan;
- (ii) review with the chief audit executive the internal audit budget, resource plan, activities, and organizational structure of the internal audit function;
- (iii) review the effectiveness of the internal audit function, including conformance with Institute of ICAI; The Institute of Internal Auditors' Definition of Internal Auditing and Code of Ethics; and the International Standards for Professional Practice of Internal Auditing; and

- (iv) on a regular basis, meet separately with the chief audit executive to discuss any matter that the committee or internal audit believes should be discussed privately.

### **C. Scope of Work**

7. The scope of internal auditing encompasses, but is not limited to, the examination and evaluation of the adequacy and effectiveness of the organizations' governance, risk management, and internal controls; as well as the quality of performance in carrying out assigned responsibilities to achieve the organization's stated goals and objectives. This includes:

- (i) evaluating risk exposure relating to achievement of the organization's strategic objectives;
- (ii) evaluating the reliability and integrity of information and the means used to identify, measure, classify, and report such information;
- (iii) evaluating the systems established to ensure compliance with those policies, plans, procedures, laws, and regulations, which could have a significant impact on the organization;
- (iv) evaluating the means of safeguarding assets and, as appropriate, verifying the existence of such assets;
- (v) evaluating the effectiveness and efficiency with which resources are employed;
- (vi) evaluating operations or programs to ascertain whether results are consistent with established objectives and goals and whether the operations or programs are being carried out as planned;
- (vii) monitoring and evaluating governance processes;
- (viii) monitoring and evaluating the effectiveness of the organization's risk management processes;
- (ix) evaluating the quality of performance of external auditors and the degree of coordination with internal audit;
- (x) reporting periodically on the internal audit activity's purpose, authority, responsibility, and performance relative to its plan;
- (xi) reporting significant risk exposures and control issues, including fraud risks, governance issues, and other matters needed or requested by the management; and
- (xii) evaluating specific operations at the request of the management, as appropriate.

**D. Professionalism**

8. The internal audit activity will govern itself by adherence to ICAI and the Institute of Internal Auditors' mandatory guidance, including the Definition of Internal Auditing, the Code of Ethics, and the International Standards for the Professional Practice of Internal Auditing (Standards). This mandatory guidance constitutes principles of the fundamental requirements for the professional practice of internal auditing and for evaluating the effectiveness of the internal audit activity's performance.

**E. Authority**

9. The internal audit activity, with strict accountability for confidentiality and safeguarding records and information, is authorized for full, free, and unrestricted access to any and all HPKVN's and the above-defined relevant institutions' records, physical properties, and personnel pertinent to carrying out any engagement in the project. All employees are requested to assist the internal audit activity in fulfilling its roles and responsibilities. The internal audit activity will also have free and unrestricted access to the board of directors of HPKVN.

**F. Independence and Objectivity**

10. The internal audit activity will remain free from interference by any element in the organization, including matters of audit selection, scope, procedures, frequency, timing, or report content to permit maintenance of a necessary independent and objective mental attitude. Internal auditors will have no direct operational responsibility or authority over any of the activities audited. Accordingly, they will not implement internal controls, develop procedures, install systems, prepare records, or engage in any other activity that may impair the internal auditor's judgment.

11. Internal auditors will exhibit the highest level of professional objectivity in gathering, evaluating, and communicating information about the activity or process being examined. Internal auditors will make a balanced assessment of all the relevant circumstances and not be unduly influenced by their own interests or by others in forming judgments.

12. The head of internal audit will confirm to the board of directors of HPKVN, at least annually, the organizational independence of the internal audit activity.

**G. Internal Audit Plan**

13. At least annually, the Head of Internal Audit will submit to senior management and the board of directors of HPKVN an internal audit plan for review and approval. The internal audit plan will consist of a work schedule as well as budget and resource requirements for the next fiscal or calendar year. The head of internal audit will communicate the impact of resource limitations and significant interim changes to senior management and the board of directors of HPKVN.

14. The internal audit plan will be developed based on a prioritization of the audit universe using a risk-based methodology, including input of senior management and the board of directors of HPKVN. The head of internal audit will review and adjust the plan, as necessary, in response to changes in the organization's business, risks, operations, programs, systems, and controls. Any significant deviation from the approved internal audit plan will be communicated to senior management and the board of directors of HPKVN through periodic activity reports.

## **H. Reporting and Monitoring**

15. A written report will be prepared and issued by the head of internal audit or designee following the conclusion of each internal audit engagement and will be distributed as appropriate. Internal audit results will also be communicated to the board of directors of HPKVN. Although the internal audit function will be continuous, the head of internal audit will issue at least four audit reports per year, i.e., on a quarterly basis.

16. The internal audit report may include management's response and corrective action taken or to be taken in regard to the specific findings and recommendations. Management's response, whether included within the original audit report or provided thereafter (within 30 days) by management of the audited area should include a timetable for anticipated completion of action to be taken, and an explanation for any corrective action that will not be implemented.

17. The internal audit activity will be responsible for appropriate follow-up on engagement findings and recommendations. All significant findings will remain in an open issues file until cleared.

**APPENDIX 5**  
**BROAD TERMS OF REFERENCE OF AUDIT COMMITTEE**

1. Recommend appointment, including the filling of a casual vacancy, remuneration, and terms of appointment of auditors (statutory and internal) of the company.
2. Review and monitor the auditor's (statutory and internal) independence and performance, and the effectiveness of audit process.
3. Examine the financial statement and the auditors' report (statutory and internal).
4. Approve any subsequent modification of transactions of the company with related parties.
5. Scrutinize intercorporate loans and investments.
6. Perform valuation of undertakings or assets of the company, whenever necessary.
7. Evaluate internal financial controls and risk management systems.
8. Monitor the end use of funds raised through public offers and related matters.
9. Solicit comments of auditors about internal control systems and scope of audit, including their observations and review of financial statements, before their submission to the board, and discuss any related issue with the internal and statutory auditors and the management of the company.
10. Investigate any matter in relation to the items specified above.
11. Examine any other matter as may be required under the Companies Act, 2013 or rules made thereunder.
12. Assess the quality of service provided by the service providers and monitor their performance on a regular basis.
13. Review the availability of funds at all implementing agencies and remove bottlenecks, if any.
14. Review workplans and budget for the project submitted by each implementing agency.
15. Review submission of utilization certificate, action taken report for audit objections and/or report, and other financial management requirements.
16. Attend to any other that may be required for smooth implementation of the project.