**REPORT OF STATUTORY AUDITORS**

To:

The Project Director,

Maharashtra State AIDS Control Society,

**Mumbai 400 031**

**Introductory Paragraph**

We have audited the accompanying financial statements of Maharashtra State AIDS Control Society under the National AIDS Control Project – Phase III (financed under World Bank Credit and DFID grant collectively referred to as “New DBS Funds”) as of March 31, 2013. These financial statements comprise of the Balance Sheet as on March 31, 2013; Statement of Income & Expenditure and Receipt & Payment Account for the period from October 1, 2012 to March 31, 2013. The management of Maharashtra State AIDS Control Society is responsible for the preparation of the accompanying financial statements in accordance with applicable law and accounting standards. Our responsibility is to express an opinion on these financial statements audited in accordance with relevant Indian legal and regulatory requirements and auditing standards.

Maharashtra State AIDS Control Society (referred to as “MSACS” or “the Society” for brevity’s sake) management's policy is to prepare the accompanying statements on cash basis in conformity with the standards prescribed by the ICAI for Cash Accounting. On this basis, cash receipts are recognized when received and cash expenditures are recognized when paid rather than when incurred. The same system is adopted in respect of amount of grants / funds spent by the NGO / periphery and other units as well as for accounting of office expenses. Hence, the amount spent by units of society as well as its employees against advance / imprest given to them is accounted for as and when the respective utilization / statement of expenditure are received.

**Scope Paragraph**

We conducted our audit in accordance with Standards on Auditing issued by the Institute of Chartered Accountants of India. Those Standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts, review of internal controls and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

As part of audit risk assessment we designed audit procedures so as to have a reasonable expectation of detecting misstatement arising from fraud or error which are material to the financial statements as a whole. However, audit procedures that are effective for detecting a misstatement that is unintentional may not be effective for a misstatement that is intentional and is concealed particularly through forgery, collusion or management override of control systems. In forming our opinion, we also evaluated the overall adequacy of the presentation of information in the financial statements.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement. We believe that our audit provides a reasonable basis for our opinion.

**Bases for opinion**

We report that -

1. MSACS Trustees/management is/are responsible for establishing and maintaining an internal control structure. In fulfilling this responsibility, estimates and judgment by management are required to assess the expected benefits and related costs of internal control structure, policies and procedures. We are neither aware of nor have we been informed of any assessment in this respect by MSACS.

The objectives of an internal control structure include policies and procedures, among other things, are:

1. to maintain records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of MSACS;
2. to provide management with reasonable, but not absolute assurance that transactions (including receipts and expenditures) are executed in accordance with management’s authorization and recorded properly as necessary to permit the preparation of the financial statements in accordance with generally accepted accounting principles; and
3. to provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the MSACS’ assets that could have a material effect on the financial statements.

Because of inherent limitations in any internal control structure, errors, irregularities or misstatements may nevertheless occur and not be detected. Also, the projection of any evaluation of effectiveness of the structure or conclusions, based on our finding, to future periods is subject to the risk that they may become inadequate because of changes in conditions; degree of compliance or the effectiveness of the design and operation of controls with the policies and procedures may deteriorate and consequently altering the validity of such conclusions that would no longer portray the system in existence.

MSACS continued its focused efforts to resolve long-term issues identified in its financial management processes and systems. Our evaluation of the prevailing internal control structure and its operation at MSACS as of and for the period ended March 31, 2013 for the purpose of expressing an opinion on the financial statements disclosed continuing weaknesses in the design or operation of the internal control structure for:

1. need to strengthen procedures for effective grant management with a central approach for accounting, management, and training for grant compliance to reduce the risks of mismanagement in grant funding;
2. formalizing arrangements in respect of grants provided to sub-recipient peripheral units to ensure accountability over sub-recipient peripheral units;
3. accounting for cost-sharing and cost-allocation to different programmes with a need to formalize the system;
4. need to improve data collection form, reporting by and oversight of DAPCUs, the district-level nodal units;
5. timely submission of Statements of expenditure/Utilization certificates by sub-recipient NGOs (including lead NGO) and peripheral units, their verification to confirm the validity of amounts reported and adequacy of the supporting documentation and ultimately their timely adjustment in the financial record of MSACS as grant expenditure;
6. records for Fixed assets (including but not limited to obsolete/discarded assets) at MSACS, sub- recipient NGOs and peripheral units;
7. records for Testing Kits at MSACS and sub-recipient peripheral units
8. in the absence of any internal audit being conducted at MSACS as well as at the lead NGO level and peripheral units level for the period, we are unable to comment on the effectiveness of the system as to the scope and coverage of the audit. As explained by the management the same is under process at several units in a phased manner, however the reports for the same are awaited;
9. vacancies in sanctioned staff positions not filled also resulting in inadequate control especially lack of segregation of duties and weak governance;
10. Management has not established a road plan or formal process to change to accrual system of accounting that will facilitate improved financial reporting and increase the financial control; in the current accounting system, there are inherent limitations and constraints on the detailed review of current assets, advances and current liabilities;
11. Management has to design an internal control system and establish procedures for dealing with discontinuance of grants to and/or termination of tie up arrangements with sub-recipient NGOs and recoveries from sub-recipient NGOs including but not limited to assets and other materials given to sub- recipient NGOs;
12. robust financial plans linked with operational plans need to be in place, and ensure that such plans are being delivered for ensuring value for money;
13. suitable insurance coverage to ensure the appropriate levels and types of coverages are in place;
14. formal policy for assuming financial obligations of employees/ex-employees who are/were on deputation from State Government, the sponsor body;
15. Operational and fiscal evaluations or reviews of sub-recipient NGOs (including lead NGO) need to be enhanced in assessing NGOs/Peripheral units’ internal control and compliance for purposes of achieving effective oversight instead of relying heavily on information obtained through interviews; Operational and fiscal evaluations or reviews presently not carried out should also be carried;.
16. oversight implications of non-compliance with –

* statutory obligations by MSACS in relation to Income Tax (including TDS on payments to Folk troupes for IEC and Event Manager for training events);
* statutory obligations by sub-recipient NGOs (including lead NGO)/peripheral units especially in relation to Income Tax (including TDS), Profession Tax and labour laws; and
* guidelines on financial and procurement systems for sub-recipient NGOs/CBOs prescribed by NACO with consequential impact on project implementation by sub-recipient NGOs/peripheral units, as the case may be;

1. monitoring activities and financial utilization for which grants are awarded by MSACS to sub-recipient NGOs/peripheral units where there is comingling or overlapping of other activities or there is funding received from other donor agencies;
2. accounting discrepancies, inappropriate accounting heads used and non-reconciliation of system- generated Financial Management Reports (FMRs) and other data with financial results on timely basis due to, among other things, application software-related problems;
3. compliance with statutory provisions of Income Tax law with respect to filing of annual income tax return and with governing organizational law for charitable/non-profit entities;
4. consistent and timely checks on monthly salaries to contractual staff before making payment and periodical management review thereof;
5. detailed periodical analyses of material variations between actual and budgeted expenditure
6. In respect of most of the expenses which have been booked /accounted on the basis of Utilisation Certificate’s received from the executing / spending units, we have relied solely on the statement submitted authenticated by the site / unit implementing officer and / or incharge. In the absence of the supporting documents, which we understand would be subject to audit at the unit, we are unable to comment on the genuineness / reasonableness of the same.

that we consider to be significant deficiencies in the design or operation of the internal control structure that, in our judgment, could adversely affect MSACS’ ability to record, process, summarize and report financial data consistent with the assertions of the management in the financial statements;

Our evaluation excluded internal controls related to IT environment and we are unable to obtain reasonable assurance about the aspects of controls that may be relevant to MSACS’ internal controls in this environment as it relates to audit of the financial statements.

These deficiencies are likely to continue to exist until internal controls are strengthened, and appropriate resources are dedicated to maintaining effective internal controls. In the interim, the Society will need to place greater emphasis on monitoring the current risks and vulnerabilities, along with the related compensating procedures, to determine whether these risks are being adequately mitigated on an ongoing basis. Successfully addressing these issues is critical to maintaining the Society’s credibility;

Generally accepted accounting principles and grant management requirements, specify the grant management and control systems be documented and designed to detect errors and fraud in the normal course of business. The lack of management and control procedures leaves MSACS vulnerable to errors and fraud in grants and to the risk of incomplete reporting and compliance with grant requirements.

1. The cost-sharing and/or cost-allocation in different programmes are done by MSACS guided, among other things, by programme budgets and relied upon by us;
2. Balances due to or from parties including but not limited to Advances/deposits given and Security Deposits received are subject to confirmation; there are old Credit and debit balances including those relating to vendors, advances and deposits given (including advances to employees) and unutilized grants funds from donor agencies that need to be, among other things, comprehensively reviewed and analyzed for ageing, and carry out appropriate adjustments on regular basis; their present status needs to be ascertained as legacy issues will continue to impair the Society’s ability to report financial information;
3. Advances have continued to be granted to sub-recipients being Peripheral Units notwithstanding that the sub-recipient Peripheral Units have continued to be irregular in submitting Statements of Expenditure/Utilization certificates in respect of prior outstanding advances; MSACS needs to strengthen mechanism for timely adjustment of advances in terms of letter no T.11025/28/2009-NACO of October 29, 2010 from NACO; in respect of such expenditure and advances, owing to inadequate controls, systems, safeguards and monitoring over its use; it is not possible for us to ascertain whether the utilization is done or likely to be done in a proper manner; Additionally, MSACS should also seek data of interest earned by peripheral units on unspent funds before releasing further advances;
4. In the absence of any master record for the running Purchase / Work order, we are unable to comment on the control for the same.
5. In terms of Office Memorandum No. G 25012/4/2008/NACO from NACO referring to the clarification vide DO No. Coord/10(1) 2010/NACO/39576 of March 4, 2012 from Central Provident Fund Commissioner, NACO and SACS are excluded from applicability of Provident Fund law to contractual employees of NACO and SACS. However, this exclusion does not extend to contractual staff employed by peripheral units, lead NGOs and other NGOs. The resulting impact, if any, of the same is not presently ascertainable.
6. The management is responsible for complying with laws and regulations applicable to the society. We performed tests of its compliance with certain provisions of laws and regulation; we limited our tests of compliance to these provisions, and we did not test compliance with all laws and regulations applicable to MSACS. Providing an opinion on compliance with certain provision of laws and regulations was not an objective of our audit and accordingly, we do not express such an opinion.
7. There is no IT/EDP systems audit nor review for security/application controls and we have not performed any additional testing on financial or other data; also there are inherent limitations in financial system software and our reliance on the data validated by management/ others as part of the audit process; we did not rely on any other systems other than to make selections for testing purposes.
8. We have not been able to review whether there is any Business Continuity Plan (BCP) and Disaster recovery policy/ procedures (DRP)
9. We have attested these financial statements as Statutory Auditors subject to approval of the same by the Executive Committee.
10. The Executive Committee and Governing Body of MSACS have to enhance their functional effectiveness to comply with the laid down rules and regulations of MSACS including but not limited to hold meetings regularly and maintain up to date Minutes Books as also in particular approve/ ratify deeds/actions which though may be in accordance with the guidelines/directions of donor agencies but nevertheless may be inconsistent with the rules and regulations of MSACS; we are unable to ascertain precisely all such inconsistencies that may be existing and the impact, if any, on the financial statements of MSACS;
11. In respect of Fixed Assets –
12. Having regard to the accounting treatment followed during the period of charging certain capital expenditure as utilization of grant, inventory records for fixed assets are to be updated and do not reconcile to the general ledger;
13. No provision has been made for depreciation and impairment, if any, of the assets.
14. identification and subsequent physical verification of fixed assets and reconciliation of discrepancies, if any, with up-dated records has not been done by the management.
15. Inventory records need to be maintained and periodical physical verification be carried out by persons other than custodians;

We understand that these requirements and other aspects such as depreciation, impairments, adjustment of shortage / excess, if any, are being dealt at NACO level. In the circumstances, we are unable to comment on the value of assets reflected in the financial statements;

1. In respect of payments to employees –
2. service book/record of employees on deputation from Government were not available to audit;
3. documents related to selection process of new appointees was not available to audit;and
4. there are several positions vacant affecting the discharge of effective procurement functions and segregation of duties by employees in overall functioning of MSACS;
5. MSACS’ operating plans have been entirely reliant on external financial support with no other plans for sustainable funding to ensure continuance of activities on self-supportive basis. In the event that external financial support was to get delayed or discontinued, there is uncertainty as to MSACS’ ability to continue with the operating plans and activities. These financial statements are prepared on the assumption that sufficient financing will continue to be provided to MSACS to enable it to continue with its plans and activities.
6. These financial statements are prepared by MSACS management generally in accordance with financial guidelines prescribed by National AIDS Control Organization (NACO) and do not strictly comply with the requirements of accounting standards prescribed by the Institute of Chartered Accountants to the extent applicable and in the manner required. The effects on the financial statements of the variances between accounting practices adopted and accounting standards, although not reasonably determinable, are presumed to be material.
7. The audit is performed on the basis on information/data furnished or made available to audit and is not responsible for misinformation and/or non-submission of information/data.
8. We did not audit management’s comments, where provided, and accordingly, we express no opinion on additional inputs provided therein by management on them.
9. Significant Accounting Policies are not disclosed as required under AS-1;
10. Many advance balances are appearing as such since long, cash balance of Rs. 4416.00 as per books of accounts is not physically available and balances of certain reserves is showing a debit balance which needs to be reconciled / adjusted.
11. As regards the matters referred to above in paragraphs 01 to 19 above read with our other observations as attached and –

* owing to the limitations explained therein; and/or
* our inability to comment on the eventual outcome; and/or
* in the absence of an adequate system, which we could rely on, and consequently our inability to perform satisfactory audit procedures; and/or
* such adjustments (not presently ascertainable) as might have been found to be necessary had we been able to satisfy ourselves as to the matters referred therein;

the financial results of MSACS as of and for the period ended March 31, 2013 may vary in step with the final determination/resolution of the issues involved. We are unable to express an opinion on such matters and the consequential effect, if any, on the financial statements of MSACS.

**Opinion Paragraph**

In our opinion, the financial statements, subject to the foregoing and annexed observations with such subsequent adjustments that may be necessary (presently not ascertainable), give a true and fair view of the Sources and Application of Funds and the financial position of Maharashtra State AIDS Control Society for the period ended March 31, 2013, in accordance with consistency applied accounting standards. These statements have been subjected to auditing procedures applied in the audit of special purpose financial statements and in our opinion and to the best of our information and according to the information and explanations given to us, is fairly stated in all material respects in relation to the special purpose financial statements taken as a whole read with our report and other observations thereon.

The information in the Utilisation Certificate is not a required part of the financial statements, but is supplementary information. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of this information. However, we did not audit this information and accordingly, we express no opinion of it.

We further report that subject to the aforesaid observations –

1. All funds sent by GOI/ State Society as grant-in-aid have been used in accordance with the conditions as laid down in the Project Implementation Plan and World Bank agreements as well as the GFATM agreement and only for the purposes for which the funds were provided;
2. All funds have been used in accordance with the relevant financing agreements, with due attention to economy and efficiency, and only for the purposes for which they were provided;
3. All expenditure, including procurement of goods and services have been carried out as per the procurement manual of the program;
4. All the goods procured and issues are supported by valid receipt and issue documents and are recorded in the stock/ inventory registers and the closing balances worked out correctly; and
5. The expenditures reported as per the quarterly FMR also are in agreement with the audited expenditure / books of accounts and variances are documented

This report, read along with the observations annexed thereto, is intended solely for the information and use of the World Bank, DFID and National AIDS Control Organisation of the Government of India as funding agencies of the National AIDS Control Program – Phase III and for submission to these funding agencies and should not be used by anyone other than these specified parties for any other purpose.

To be read along with other observation annexed.

**For MKPS & Associates**

**Chartered Accountants**

**Firm’s Regn No. 302014E**

**CA Narendra Khandal**

**Partner**

**M No. 065025**

**Mumbai, August 7, 2013**

