

Inaugural Address of Hon'ble Shri V.N. Kaul, Comptroller & Auditor General of India at The Round Table Meeting of Directors (Finance) of Public Sector Undertakings with ICAI Held on 30th January 2003 At Hotel Le Meridien, New Delhi

I would like to thank the Institute of Chartered Accountants of India (ICAI) for inviting me to the Round Table Meeting of Directors (Finance) of Public Sector Undertakings. There is a need to look into various accounting and audit related problems which Public Sector Undertakings (PSUs) are likely to face in the context of changes anticipated in accounting and auditing practices in the future. I am happy that the Institute of Chartered Accountants of India has taken a lead in this matter.

In almost every developed country a review is being undertaken of how companies, including parastatals, are governed. In the United States two sets of proposals have emerged, one from the US Government in the shape of Sarbanes Oxley Act and the other from the New York Stock Exchange. The Securities and Exchange Commission of US is grappling with these in order to come up with a coherent set of rules. In Germany, the Cromme Committee has produced a code of corporate governance. In Canada, the Council of Chief Executives has proposed new guidelines for listed companies. In France and Britain, similar reviews are being undertaken focusing in one case on best corporate governance practices and in the other on the role of non-executive directors. I was recently in South Africa where the Finance Minister of the Republic informed us that they have set up a Committee corresponding to the Naresh Chandra Committee with almost similar terms of reference.

The Indian Public Sector Companies will not remain unaffected by these "tectonic" changes in the areas of accounting and auditing. Now that the report of the Naresh Chandra Committee has been made public, it is appropriate to focus on specific issues involved in the debate that have relevance for the public sector. The public sector in India has its own unique set of issues relating to corporate governance over and above issues of global relevance to all companies.

Of foremost importance to the public sector in India is the question of the accountability of the Board of Directors. This issue has a nexus with the question of autonomy of a Public Sector Undertaking and indeed with corporate governance in PSUs. It has been argued that the presence of Government directors on the Board of PSUs dilutes the autonomy of the Board and makes the Board excessively risk averse. Instead of safeguarding Governments stake, the presence of Government direc-

tors is alleged to cause interference in the working of a Public Sector Undertaking. There is obviously a need to review the system. The question of replacing Government servants on the Boards of PSUs by truly independent directors as Government nominees needs to be studied seriously. Independent experts with relevant management or subject matter experience may add more value to the deliberations of the Board and foster a greater degree of autonomy in the working of Public Sector Undertakings.

A related issue is the question of audit independence. The absence of qualified independent directors in Public Sector Undertakings affects the formation of a truly effective Audit Committee. The existing Audit Committees in most Public Sector Undertakings fail to provide meaningful guidance to internal auditors and are therefore unable to discharge the full range of responsibilities under section 292 A of the Companies Act. Restructuring of Board of Directors with an eye on the composition of Audit Committees in Public Sector Undertakings should be considered. Audit Committees in PSUs have remained ineffective particularly in regard to

- assessing risks and in overseeing internal audit arrangements;
- exercising oversight over financial reporting;
- evaluating the audit process.

Audit committees need to be alert to the indicators of business risk, and mechanisms should be established to enable the Audit Committee to obtain periodic assurance on the internal control environment. This is possible only if there is a transparent process of identifying, capturing and communicating pertinent information across the various levels of the organization. There should be independent flow of information between the Audit Committee and Internal Audit, and the findings of internal and external auditors should be reviewed by the Audit Committee.

This brings me to the question of another related issue. The arrangements for internal audit in most Public Sector Undertakings need to be improved. In many Public Sector Undertakings the internal audit wing forms part of the Finance Division. In most Public Sector Undertakings internal audit loses sight of its main objective of ensuring that internal controls are in place to mitigate enterprise-wide risks. The purpose, authority and responsibility of internal audit activity should be formally

defined in a charter and approved by the Board of all Public Sector Undertakings. The nature of internal audit services to be provided should also be defined in detail in an audit charter. The internal audit staff should be carefully selected to ensure that they have the knowledge, skills and competence to perform their task. In the public sector more than elsewhere they must have the particular ability to identify indicators of fraud. Quality assurance reviews should be conducted in a timely manner. In short, internal audit activity must be seen as a critical activity that contributes to improving the governance process.

I would also like to draw attention to problems in accounting practices and policies that have come to our notice in audit. Some common problems are:

- actual liabilities on taxation etc. are shown as contingent liabilities;
- ownership or right to productive use of land is in many cases uncertain as conveyance deeds are not registered;
- amounts recoverable from Government and other PSUs are shown as 'good' debts even after 10 to 15 years and sometimes upto 30 years;
- inventory of assets is not complete and many times it is not verified systematically. The distinction between 'core' and 'peripheral' assets in relation to the 'going concern' assumption is not clear. This is a particularly vulnerable area for PSUs slated for disinvestment;
- Explanatory Notes to Accounts run to several pages and contain disclosures that tantamount to qualifying the 'true and fair' view;
- Statutory Auditors do not give an adverse opinion on 'true and fair' view even with several pages of material qualifications.

As regulatory frame-works for accounting become more robust the need for more stringent standards and their compliance would be felt. We have noticed that staffing of accounts departments by inadequately qualified persons remains a problem in PSUs and deserves priority attention. This problem extends sometimes right upto the level of the Director in charge particularly in State Public Sector Undertakings. The need for professionalism in this area is obvious.

The ICAI has traditionally provided imaginative leadership to the accounting profession in the private as well as the public sectors in this country. Their contribution towards establishing national standards of global quality in accounting and auditing, and towards raising the expertise of accounting professionals is indeed com-

mendable. Therefore, I am glad that this Round Table Meeting organised by ICAI will discuss some contemporary issues in accounting and auditing like social audit, energy audit and environmental accounting so relevant for the public sector. However, ICAI's activities need greater focus on industries like coal, petroleum and power that are mainly in the public sector and have to face some unique problems. Sector specific guidance on such issues appears necessary. I believe this practice has already been initiated for the petroleum sector.

Let me conclude by saying that above all what is needed to-day in the public sector as a whole is a new definition of accountability that takes the recent changes in our economic policy and its management into account. We must recognize that accountability is a relationship based on obligations to demonstrate, review and take responsibility for performance of both, the results achieved in the light of agreed expectations and the means used. Effective accountability in the public sector cannot be secured by a system based on traditional command and control mechanisms. In our public sector companies, real accountability has been diluted by mismanagement of the relationship between the Government and its companies and by the use of inappropriate control mechanisms. It is of critical importance that accountability relationships are modernized in the public sector in India. This can be achieved if there is:

- (1) a clearer delineation of roles and responsibilities of the Board of Directors of PSUs;
- (2) a precise expression of performance expectations by the Government from PSUs in view of the virtual collapse of the MOU system;
- (3) a balance of expectations with capabilities taking external constraints into account;
- (4) a system of credible and transparent reporting of performance;
- (5) greater nexus between the review of performance and adjustment between Government and the PSU.

This new accountability relationship must be able to tolerate mistakes or adverse results provided that any risk taken can be shown to have been reasonable and that the system of management of risk in the undertaking is objectively determined to be basically sound. Such a new relationship will promote better corporate governance and, therefore, better performance in the public sector and it will be more effective than any tinkering with the controls or with ownership structures. I hope that the Institute of Chartered Accountants of India will play an active role in fostering such a relationship.

I wish you success in your deliberations. ■