CHAPTER 18

Audit of Public Sector Undertakings

Question 1

What are the principles involved regarding "Propriety audit' in the case of Public Sector Undertaking?

Answer

Section 619 of the Companies Act, 1956 lays down special provisions regarding audit of accounts of public sector undertakings registered as Government Companies. Section 619(4) of the Companies Act, 1956 empowers C&AG to conduct supplementary or test audit. Audit of public enterprises in India is not restricted to financial and compliance audit; it extends also to efficiency, economy and effectiveness with which these operate and fulfil their objectives and goals. Another aspect of audit relates to questions of propriety; this audit is directed towards an examination of management decisions in sales, purchases, contracts, etc. to see whether these have been taken in the best interests of the undertaking and conform to accepted principles of financial propriety. Propriety audit stands for verification of transactions on the tests of public interest, commonly accepted customs and standards of conduct. On an analysis, these tests boil down to tests of economy, efficiency and faithfulness. Instead of too much dependence on documents, vouchers and evidence, it shifts the emphasis to the substance of transactions and looks into the appropriateness thereof on a consideration of financial prudence, public interest and prevention of wasteful expenditure. Thus, propriety audit is concerned with scrutiny of executive actions and decisions bearing on financial and profit and loss situation of the company, with special regard to public interest and commonly accepted customs and standards of conduct. It is also seen whether every officer has exercised the same vigilance in respect of expenditure incurred from public money, as a person of ordinary prudence would exercise in respect of expenditure of his own money under similar circumstances. Some general principles have been laid down in the Audit Code, which have for long been recognised as standards of financial propriety. Audit against propriety seeks to ensure that expenditure conforms to these principles which have been stated as follows:

(i) The expenditure should not be prima facie more than the occasion demands. Every public officer is expected to exercise the same vigilance in respect of expenditure incurred from public moneys as a person of ordinary prudence would exercise in respect of expenditure of his own money.

(ii) No authority should exercise its powers of sanctioning expenditure to pass an order which will be directly or indirectly to its own advantage.

(iii) Public moneys should not be utilised for the benefit of a particular person or section of the community.

(iv) Apart from the agreed remuneration or reward, no other avenue is kept open to indirectly benefit the management personnel, employees and others.

It may be stated that it is the responsibility of the executive departments to enforce economy in public expenditure. The aim of propriety audit is to bring to the notice of the proper authorities of wastefulness in public administration and cases of improper; avoidable and in fructuous expenditure.

Question 2

Write a short note on - Propriety Audit.

Answer

Propriety Audit: Propriety Audit stands for verification of transactions on the tests of public interest commonly accepted customs and standards of conduct. E.L. Kohler has defined the term propriety as "that which meets the tests of public interest, commonly accepted customs and standards of conduct, and particularly as applied to professional performance, requirements of law, government regulations and professional codes". Instead of too much dependence on documents, vouchers and evidence, it shifts the emphasis to the substance of the transactions and looks into the appropriateness thereof on a consideration of financial prudence, public interest and prevention of wasteful expenditure. Thus propriety audit is concerned with scrutiny of executive actions and decisions bearing on financial and profit and loss situation of the company with special regard to public interest and commonly accepted customs, and standards of conduct. It is also seen whether every offer has exercised the same vigilance in respect of expenditure incurred from public money, as a person of ordinary prudence would exercise in respect of expenditure of his own money under similar circumstances. Propriety requires the transactions, and more particularly expenditure, to conform to certain general principles. These principles are:

(i) that the expenditure is not prima facie more than the occasion demands and that every official exercises the same degree of vigilance in respect of expenditure as a person of ordinary prudence would exercise in respect of his own money;

(ii) that the authority exercises its power of sanctioning expenditure to pass an order which will not directly or indirectly accrue to its own advantage;

(iii) that funds are not utilised for the benefit of a particular person or group of persons and

(iv) that, apart from the agreed remuneration or reward, no other avenue is kept open to indirectly benefit the management personnel, employees and others.

The Parliament and Government, with a view to knowing the standards of efficiency, propriety, cost consciousness and economy, have already come up with some provisions in the Companies Act, 1956 having direct or indirect bearing on propriety; some of these provisions are:

(i) Section 209(1) (d) relating to Cost Accounting Records.

(ii) Section 227(1A) requiring enquiry into certain specified matters.

(iii) Section 227(4A) requiring a supplementary statement on matters specified in the Companies (Auditor's) Report Order.

(iv) Section 233B - requirement of Cost Audit.

(v) Section 619(3)(a) requiring a supplementary statement in respect of the Government Companies on matters specified.

(vi) Certain information in Revised Schedule VI, Part II.

Problems in propriety audit, however, arise mainly because of its distinct nature. The expression "propriety" is a moral term and can be understood by reference to the concept of morality accepted by the society at a given time. In any auditing, the essential test lies in formulation of auditing propositions. In the audit of financial accounts by reference to financial and legal requirements, propositions are built up about happening of events, existence, accuracy, title, ownership, compliance with law and internal regulations, etc., which are all verifiable. Propriety audit has an inherent element of subjectivity because it is very difficult to establish standards of public interest, commonly accepted customs, standards for conduct which are not firm basis for audit evaluation. To take care of this situation, the C&AG has developed the norms of propriety for expenditure of public funds in our country .By laying down the standards of propriety for Government expenditure the C&AG has really tried to tackle in a practical way the complex problem of subjectivity inherent in a situation calling for propriety consideration.

Another dimension of the problem noticed in the application of propriety norms in the Government sector needs also to be taken into account. The norms are applied often too mechanically and create problems for expeditious and efficient working. In private sector, this attitude may prove counter-productive. Propriety as a moral element should be a matter of evaluation based on objectives and prevailing circumstances. The element of subjectivity has caused proper discharge of duty very delicate and demands discretion, but wisdom of taking commercial decisions under dynamic environment (the economic, social and political) must be evaluated with reference to the circumstances in which these were taken and therefore, the auditor in his field must reconstruct such circumstances. The judgement of the auditor must be objective as otherwise it would dampen the initiative of management and others in taking commercial decisions and propriety audit would prove itself to be counter productive.

Question 3

What is a comprehensive audit of public enterprises? Discuss some of the areas to be examined therein.

Answer

Comprehensive Audit of Public Enterprises: Areas to be examined: The scope and extent of audit of public sector enterprises is determined by the Comptroller and Auditor General of

India. Audit of public enterprises in India is not restricted to financial and compliance audit; it extends also to efficiency, economy and effectiveness with which these operate and fulfil their objectives and goals. Another aspect of such audit relates to questions of propriety; this audit is directed towards an examination of management decisions in sales, purchases, contracts, etc. to see whether these have been taken in the best interests of the undertaking and conform to accepted principles of financial propriety. Comprehensive audit involves assessing efficiency and effectiveness of public enterprises in its entirety to be conducted on the basis of certain standards and criterion. Public enterprises have been set-up with socio-objectives. An objective assessment with reference to such objectives' fulfillment would require comprehensive audit.

The starting point of a comprehensive audit of a public enterprise, which covers aspects of economy, efficiency and effectiveness, is the preparation of an audit programme based on the study of decisions relating to the setting up of the enterprise, its objectives, the areas of operation, organisation, financial and operational details available in the annual reports and accounts, capital and operational budgets, deliberations of the board of directors, material in the earlier audit inspection reports on the enterprise and other relevant available papers. These audit programmes (or guidelines) identify the areas/aspects which require further detailed audit analysis and criteria, the data required for such analysis and the sources of such data, the extent of the audit analysis including the test checks to be applied and the instructions to the audit parties assigned to the work.

The areas covered by comprehensive audit are those of investment decisions, project formulation and management, organisation, delegation of powers and management information systems, organisational effectiveness, capacity utilisation, management of equipment, plant and machinery, production performance, use of materials, productivity of labour, idle capacity, costs and prices, development of complementary ancillary small scale industries, materials management, sales and credit control, budgetary and internal control systems, etc. The areas covered in comprehensive audit will naturally vary from enterprise to enterprise depending on the nature of the enterprise, its objectives and operations. Some of the broad areas are listed below:

- Comparison of overall capital cost of the project with the approved planned costs.
- Production or operational outputs vis-a-vis under-utilisation of the installed capacity.
- Systems of project formulation and implementation.
- Planned rate of return
- Cost control measures.
- Research and development programmes.
- System of repairs and maintenance.
- adequate purchase policies
- Effective and economical procedures

- Project planning
- Undue waste, unproductive time for men and machines, wasteful utilisation or even non-utilisation of resources

Question 4

Write a short explanatory note on - Areas of propriety audit under Section 227(1A) of the Companies Act, 1956.

Answer

Areas of propriety audit under Section 227(1A)

Section 227(1A) of the Companies Act, 1956 requires the auditor to make an enquiry into certain specific areas. In some of the areas, the auditor has to examine the same from propriety angle as to:

(i) Whether loans and advances made by the company on the basis of security have been properly secured and whether the terms on which they have been made are not prejudicial to the interests of the company or its members;

(ii) Whether transactions of the company which are represented merely by book entries are not prejudicial to the interests of the company;

(iii) Whether the company is not an investment of company within the meaning of section 372 or a banking company, whether so much of the assets of the company as consist of shares, debentures and other securities have been sold at a price less than that at which they were purchased by the company;

(iv) Whether loans and advances made by the company have been shown as deposits. Again, considering the propriety element, rationalizing the proper disclosure of loans and advance given by company is made;

(v) Whether personal expenses have been charged to revenue account;

(vi) In case it is stated in the books and papers of the company that shares have been allotted for cash, whether cash has actually been received in respect of such allotment, and if no cash actually received, whether the position in books of account and balance sheet so stated is correct, regular and not misleading. A control has been set up to verify the receipt of cash in case of allotment of shares for cash. Further, if cash is not received, the books of accounts and statement of affairs shows the true picture.

Question 5

Write short notes on general principles relating to propriety aspect.

Answer

General principles to be confirmed by Propriety: Propriety audit stands for verification of transactions on the tests of public interest, commonly accepted customs and standards of conduct.

On an analysis, the tests boil down to tests on economy, efficiency and faithfulness. Instead of too much dependence on documents, vouchers and evidence, it shifts the emphasis to the substance of transactions and looks into the appropriateness thereof on a consideration of financial prudence, public interest and prevention of wasteful expenditure. Thus, propriety audit is concerned with scrutiny of executive actions and decisions bearing on financial and profit and loss situation of the company, with special regard to public interest and commonly accepted customs and standards of conduct. It is also seen whether every officer has exercised the same vigilance in respect of expenditure incurred from public money, as a person of ordinary prudence would exercise in respect of expenditure of his own money under similar circumstances.

Propriety requires the transactions, and more particularly expenditure, to conform to certain general principles. These principles are:

(i) The expenditure is not prima facie more than the occasion demands and that every official exercises the same degree of vigilance in respect of expenditure as a person of ordinary prudence.

(ii) That the authority exercises its powers of sanctioning expenditure which will not result in any benefit directly or indirectly to such authority.

(iii) That the funds are not utilised for the benefit of a particular person or group of persons and

(iv) That, apart from the agreed remuneration or reward, no other revenue is kept open to indirectly benefit the management personnel, employees or others.