



# AUDIT OF PUBLIC SECTOR UNDERTAKINGS

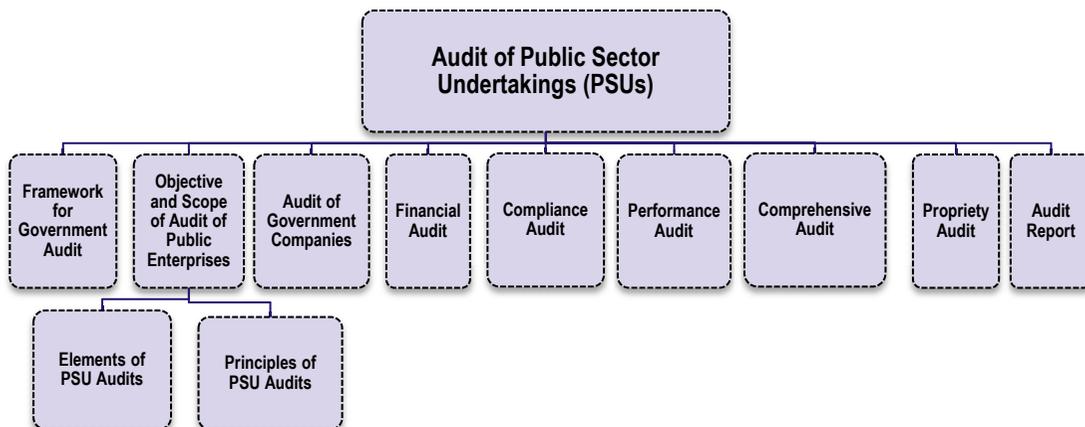


## LEARNING OUTCOMES

After studying this chapter, you will be able to:

- ❑ Understand & explain the concept of Compliance Audit, Performance Audit, Comprehensive Audit & Propriety Audit in relation to C&AG of India.
- ❑ Apply & analyse the above-mentioned concepts in moderately complex scenarios.

## CHAPTER OVERVIEW

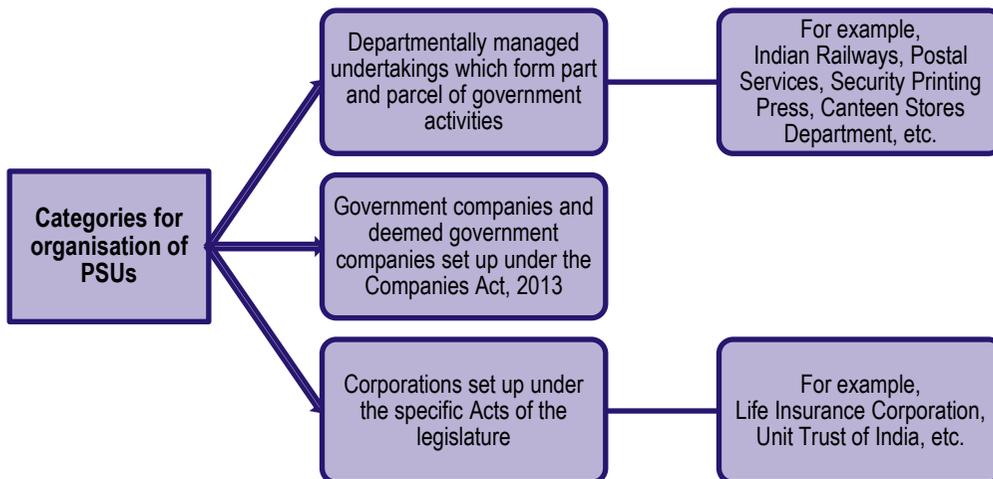


## 1. INTRODUCTION

Public sector undertakings in India are fundamentally owned or controlled by central government, or any state government or governments, or partly by the central government and one or more state governments. The public enterprises have been assigned a key role in the socio-economic development of the country. These enterprises are industries supplying basic inputs to industry and agriculture, such as coal, oil, steel, minerals and metals, cement, chemicals and fertilizers and heavy equipment. Public utilities like the railways, postal and telecom services, electricity generation and supply, road transport, etc. constitute another class of public enterprises. Though in the past, the public sector in India has achieved a dominant role in the national economy, the private sector is also now actively allowed in various sectors like electricity generation, telecom services, etc.



Fig.: Audit of PSUs\*

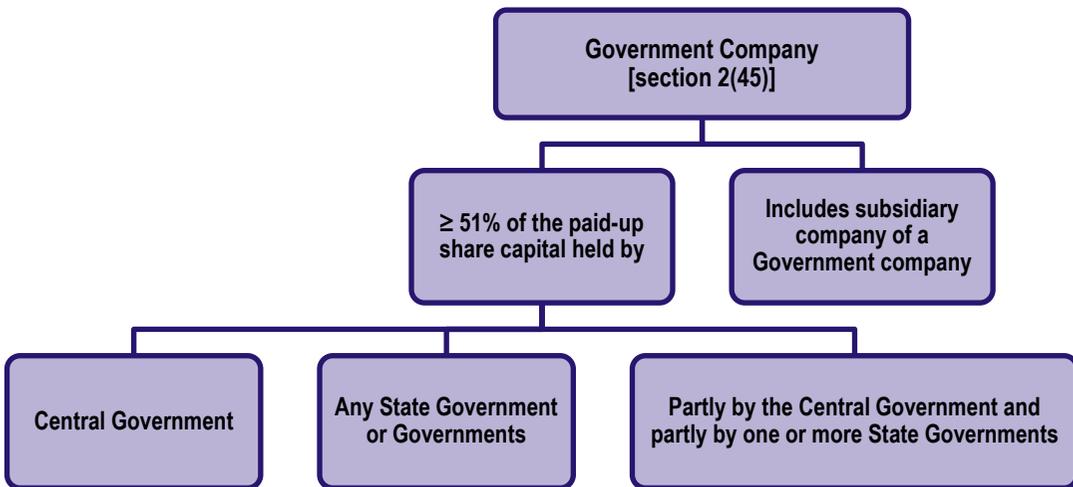


## 2. FRAMEWORK FOR GOVERNMENT AUDIT

As defined under section 2(45) of the Companies Act, 2013, a “**Government Company**” is a company in which not less than 51% of the paid-up share capital is held by the Central Government or by any State Government or Governments or partly by the Central Government and partly by one

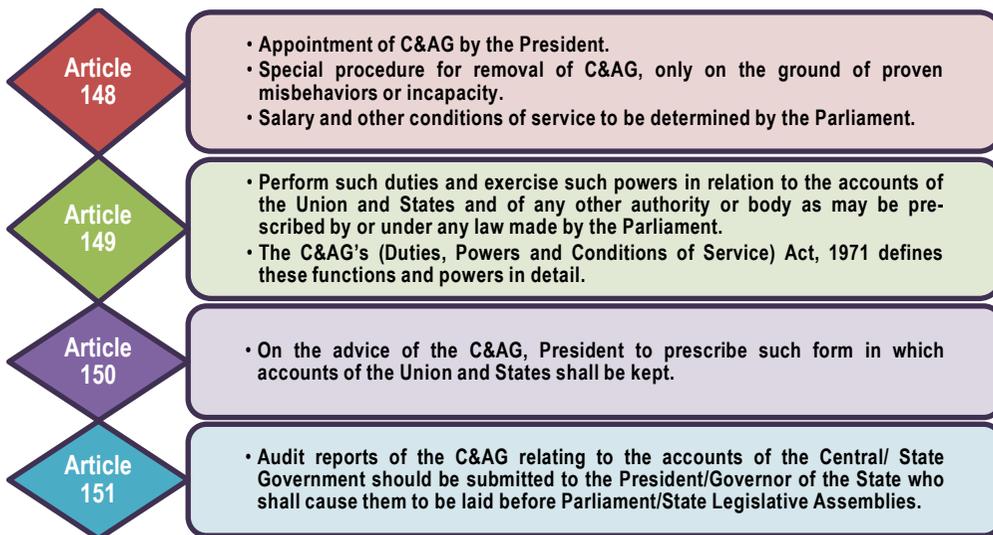
\* Source of image: Times of India

or more State Governments, and includes a company which is a subsidiary company of such a Government company.



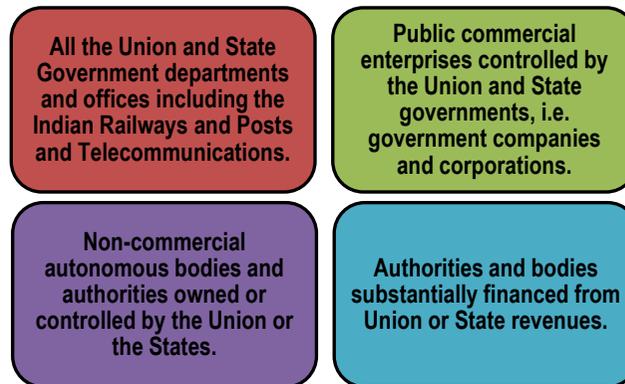
In India, audit of the above government companies is performed by an independent constitutional authority, i.e. Comptroller and Audit General of India (C&AG), through the Indian Audit and Accounts Department. The Constitution of India gives a special status to the C&AG and contains provisions to safeguard his independence.

**Article 148 to 151 of the Constitution** prescribes the role of C&AG as follows:



The Comptroller and Audit General's (Duties, Power and Conditions of Services) Act, 1971, prescribes that the C&AG shall hold office for a term of six years or upto the age of 65 years, whichever is earlier. He can resign at any time through a resignation letter addressed to the President. The Act also assigns the duties regarding the audit to be followed by C&AG.

The number of organisations subject to the audit of the Comptroller and Auditor General of India is very large. This includes:



As a result of these numerous audits carried out every year, the Comptroller and Auditor General of India has been issuing a large number of audit reports.

**Audit of Government Companies (Commercial Audit)** – There is a special arrangement for the audit of companies where the equity participation by Government is 51 percent or more. The auditors of these companies are firms of Chartered Accountants, appointed by the Comptroller & Auditor General, who gives the auditor directions on the manner in which the audit should be conducted by them. He is also empowered to comment upon the audit reports of the auditors. In addition, he has a right to conduct a supplementary audit of such companies and cause test audit if considered necessary, by an order.

**[Note: Audit of Government companies is discussed separately under Para 4]**

**Audit Board Setup in Commercial Audit** – A unique feature of the audit conducted by the Indian Audit and Accounts Department is the constitution of Audit Boards for conducting comprehensive audit appraisals of the working of Public Sector Enterprises engaged in diverse sectors of the economy.

These Audit Boards associate with them experts in disciplines relevant to the appraisals. They discuss their findings and conclusions with the managements of the enterprises and their controlling ministries and departments of government to ascertain their view points before finalisation.

The results of such comprehensive appraisals are incorporated by the Comptroller and Auditor General in his reports.

These Audit Boards have no separate legal entity and work under the supervision and control of the Comptroller and Auditor General.

**Action on Audit Reports** – The scrutiny of the Annual Accounts and the Audit Reports thereon by the Parliament as a whole would be an arduous task, considering their diverse and specialised

nature, besides imposing excessive demands on the limited time available to the Parliament for discussion of issues of national importance.

Therefore, the Parliament and the State Legislatures have, for this purpose, constituted specialized Committees like the Public Accounts Committee (PAC), Estimates Committee and the Committee on Public Undertakings (COPU), to which these audit Reports and Annual Accounts automatically stand referred.

**Public Accounts Committee (PAC)** – It is the duty of the Public Accounts Committee to satisfy itself:

- (i) that the moneys were disbursed legally on the service or purpose to which they were applied;
- (ii) that the expenditure incurred was authorised;
- (iii) that re-appropriation has been made in accordance with the provisions made (i.e. distribution of funds).

It is also the duty of the PAC to examine the statement of accounts of autonomous and semi-autonomous bodies, the audit of which is conducted by the Comptroller & Auditor General either under the directions of the President or by a Statute of Parliament.

**Estimates Committee** – The Committee examines the estimates with a view to:

- (i) report that economies, improvements in organization, efficiency, consistent with the policy underlying the estimates may be effected;
- (ii) suggest alternative policies;
- (iii) examine whether the money is well laid out within the limit; and
- (iv) suggest the form in which the estimates shall be presented to Parliament.

The Committee does not comment upon a policy approved by Parliament, but where there is evidence that a particular policy is not leading to the desired results, or is leading to waste, it is the duty of the Committee to bring it to the notice of the House.

**Committee on Public Undertakings (COPU)** – The Committee on Public Undertakings exercises the same financial control on the public sector undertakings as the PAC exercises over the functioning of the Government departments. The functions of the Committee are -

- (i) to examine the reports and accounts of public undertakings.
- (ii) to examine the reports of the C&AG on public undertakings.
- (iii) to examine the autonomy and efficiency of public undertakings and to see whether they are being managed in accordance with sound business principles and prudent commercial practices.
- (iv) to exercise such other functions vested in the PAC and the Estimates Committee as are not covered above and as may be allotted by the Speaker from time to time.

The examination of public enterprises by the Committee takes the form of comprehensive appraisal or evaluation of performance of the undertaking. It involves a thorough examination, including evaluation of the policies, programmes and financial working of the undertaking.

The objective of the Financial Committees, in doing so, is not to focus only on the individual irregularity, but on the defects in the system which led to such irregularity, and the need for correction of such systems and procedures.

**C&AG's Role** – The Comptroller & Auditor General of India plays a key role in the functioning of the financial committees of Parliament and the State Legislatures. He has come to be recognised as a 'friend, philosopher and guide' of the Committees.

- (i) His Reports generally form the basis of the Committees' working, although they are not precluded from examining issues not brought out in his Reports;
- (ii) He scrutinises the notes which the Ministries submit to the Committees and helps the Committees to check the correctness of submissions to the Committees and facts and figures in their draft reports;
- (iv) The Financial Committees present their Report to the Parliament/ State Legislature with their observations and recommendations.

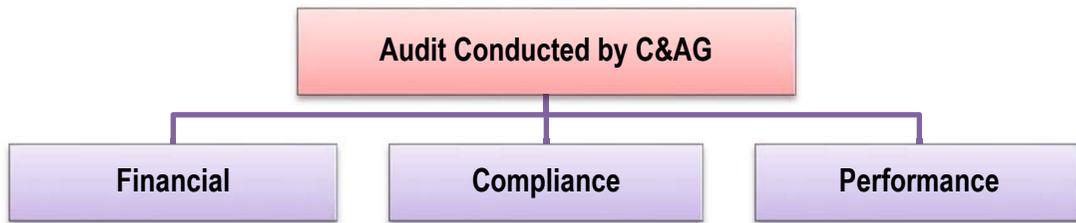
The various Ministries / Department of the Government are required to inform the Committees of the action taken by them on the recommendations of the Committees (which are generally accepted) and the Committees present Action Taken Reports to Parliament / Legislature;

- (v) In respect of those Audit Reports, which could not be discussed in detail by the Committees, written answers are obtained from the Department / Ministry concerned and are sometimes incorporated in the Reports presented to the Parliament / State Legislature.

This ensures that the Audit Reports are not taken lightly by the Government, even if the entire report is not deliberated upon by the Committee.

### 3. OBJECTIVE AND SCOPE OF PUBLIC ENTERPRISES AUDIT

The C&AG's (Duties, Power and Conditions of Services) Act, 1971 specifies the entities that come under audit purview of C&AG at the Union and State level. However, the scope and extent of audit is determined by the C&AG itself.



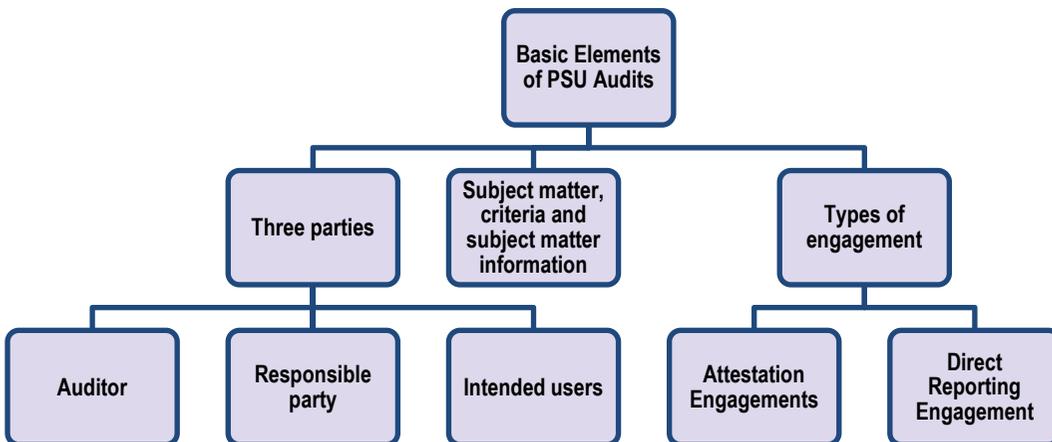
- (1) **Audit of PSUs not constrained to Financial and Compliance Audit:** Audit of public enterprises in India is not restricted to financial and compliance audit; it extends also to performance (efficiency, economy and effectiveness) with which these operate and fulfill their objectives and goals.
- (2) **Propriety Audit:** 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.
- (3) **Comprehensive Audit:** Under comprehensive audit, the C&AG do not really cover again the field which has already been covered. He conducts an appraisal or an efficiency-cum-performance audit. He sees whether the undertakings have fulfilled the objectives for which they have been established, whether value-for-money spent has been obtained, whether the targets have been achieved, etc. He locates the areas of weakness including review of the decisions taken by the management and a comprehensive appraisal of the performance of the undertaking.
- (4) **Organisation's Decision to be taken by Competent Authority:** In examining the decisions of a management, the auditor examines that these were taken by the competent authority after examination of all aspects (economic, technological, public interest) on the basis of all the relevant information available at that time and taking into consideration the different alternatives available to management and that the decisions were consistent with the aims and objectives of the enterprise.
- (5) **Helping Government:** Audit is an instrument of accountability. But an equally important purpose of audit of public enterprises in India is to help the Government and the enterprise managements improve their efficiency and effectiveness. This is achieved by bringing out financial and operational deficiencies, inadequacies or ineffectiveness of systems, shortfalls in performance, etc. and by analysing the causes of shortfall from acceptable standards of performance.
- (6) **Highlighting Issues of Efficient and Economic Operations:** Financial performance is linked with physical performance and issues of efficient and economic operations and management of resources are highlighted. There is an increasing emphasis on audit being an instrument of improvement.

- (7) **Fiscal and Managerial Accountability:** In the broader context, Government audit encompasses **two main elements**, viz., (a) **Fiscal Accountability:** It includes audit of provisions of funds, sanctions, compliances and propriety; and (b) **Managerial Accountability:** It includes audit of efficiency, economy and effectiveness (This is often referred to as **efficiency-cum-performance audit**).

### 3.1 Elements of PSU Audits

Public sector auditing augments the confidence of the intended users by providing relevant information and independent and objective assessments concerning deviations from accepted standards or principles of good governance.

**Audit of all public-sector undertakings has the following basic elements:**



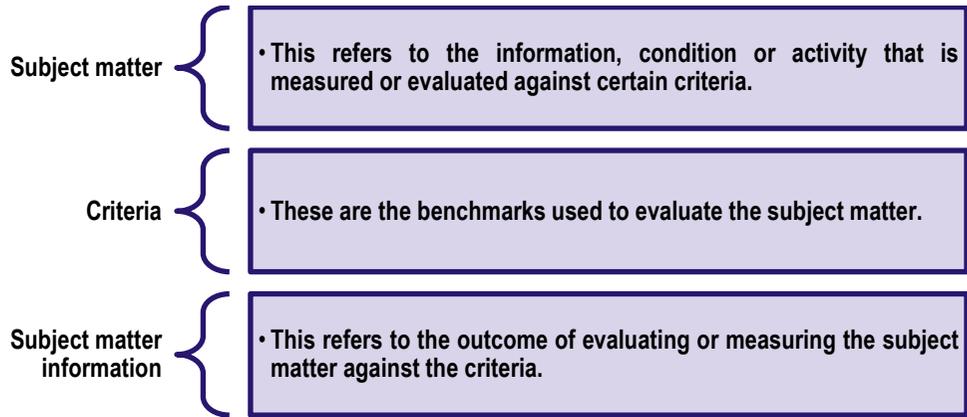
(a) **The Three parties - Auditor, Responsible Party and Intended Users.**

**Auditor:** The role of auditor is fulfilled by Supreme Audit Institution (SAI), India and by its personnel delegated with the duty of conducting audits.

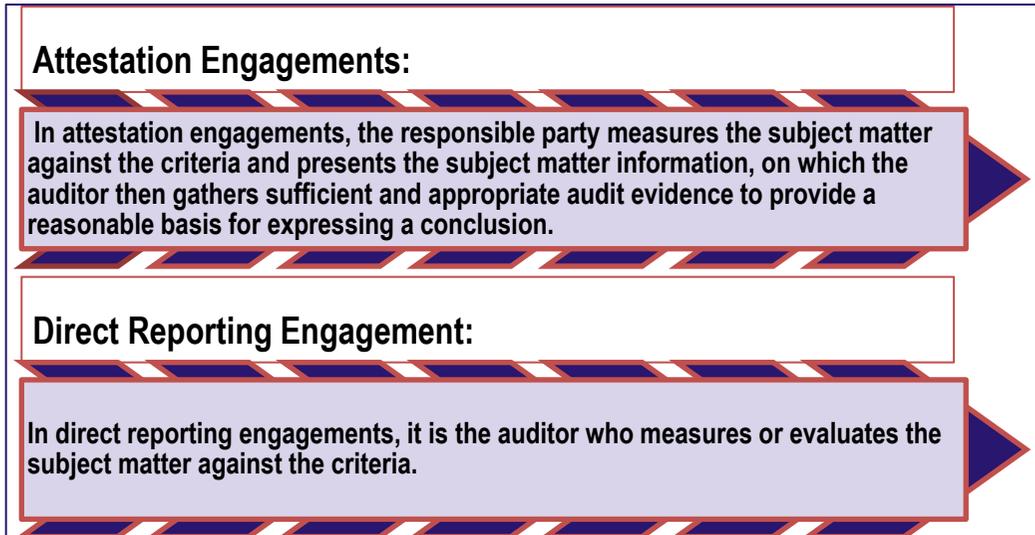
**Responsible Party:** The relevant responsibilities are determined by constitutional or legislative arrangement. Generally, auditable entities and those charged with governance of the auditable entities would be the responsible parties. The responsible parties may be responsible for the subject matter information, for managing the subject matter or for addressing recommendations.

**Intended Users:** Intended users are the individuals, organizations or classes thereof for whom the auditor prepares the audit report.

(b) Subject matter, criteria and subject matter information.



(c) Types of engagement - Attestation Engagements and Direct Reporting Engagement.



**Financial audits** are always **attestation engagements**, as they are based on financial information presented by the responsible party.

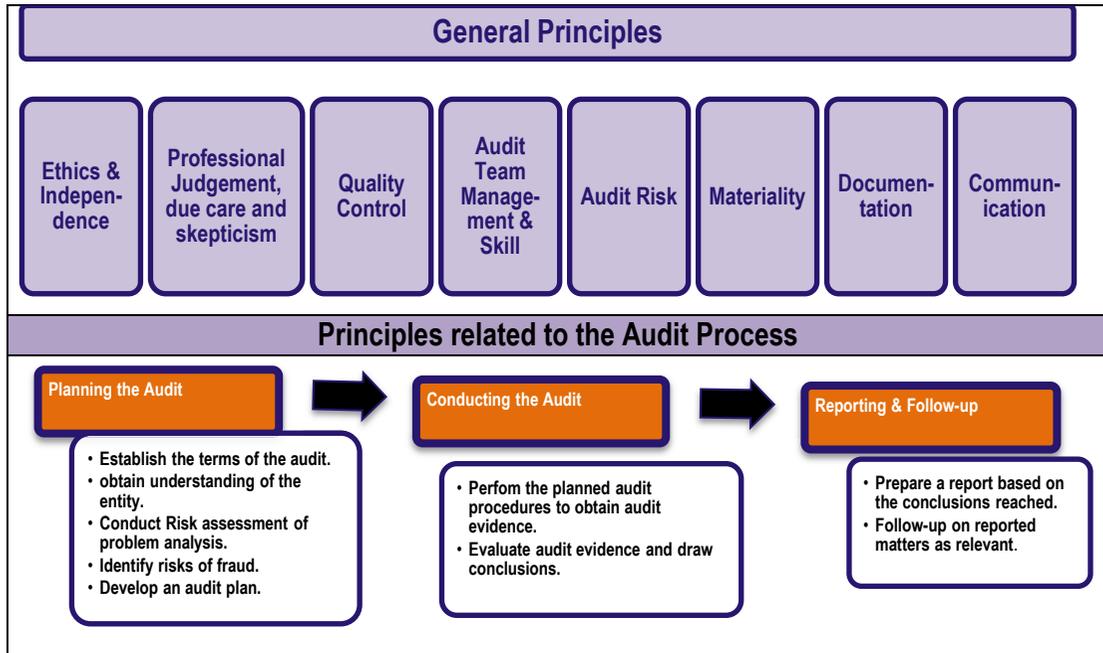
**Performance audits and compliance audits** are generally **direct reporting engagements**.

### 3.2 Principles of PSU Audits

The principles of PSU Audits constitute the general standards that apply to SAI India’s personnel as auditors and are fundamental to the conduct of all types of PSU Audits.

The principles are categorized into two distinct groups as below:

- I. General Principles
- II. Principles related to the Audit Process



## 4. AUDIT OF GOVERNMENT COMPANIES

The following steps are involved in the audit of government companies:

- (a) **Appointment of Auditors under Section 139(5) and 139(7) read with section 143(5) of the Companies Act, 2013** - Statutory auditors of Government Companies are appointed or re-appointed by the C&AG. There is thus, a departure from the practice in vogue in the case of private sector companies where appointment or re-appointment of the auditors and their remuneration are decided by the members at the annual general meetings. In the case of government companies, though the appointment of statutory auditors is done by the C&AG, the remuneration is left to the individual companies to decide based on certain guidelines given by the C&AG in this regard.

The C&AG may direct the appointed auditor on the manner in which the accounts of the Government company are required to be audited and the auditor so appointed has to submit a copy of the audit report to the Comptroller and Auditor-General of India. The report, among other things, includes the directions, if any, issued by the C&AG, the action taken thereon and its impact on the accounts and financial statement of the company.

The report under section 143(5) is in addition to the reports issued by the Statutory Auditors under various other clauses of section 143.

- (b) **Supplementary audit under section 143(6)(a) of the Companies Act, 2013** - The Comptroller and Auditor-General of India shall within 60 days from the date of receipt of the audit report have a right to conduct a supplementary audit of the financial statements of the government company by such person or persons as he may authorize in this behalf and for

the purposes of such audit, require information or additional information to be furnished to any person or persons, so authorised, on such matters, by such person or persons, and in such form, as the C&AG may direct.

- (c) **Comment upon or supplement such Audit Report under section 143(6)(b) of the Companies Act, 2013** - Any comments given by the C&AG upon, or in supplement to, the audit report issued by the statutory auditors shall be sent by the company to every person entitled to copies of audited financial statements under sub-section (1) of section 136 of the said Act i.e. every member of the company, to every trustee for the debenture-holder of any debentures issued by the company, and to all persons other than such member or trustee, being the person so entitled and also be placed before the annual general meeting of the company at the same time and in the same manner as the audit report.
- (d) **Test audit under section 143(7) of the Companies Act, 2013** - Without prejudice to the provisions relating to audit and auditor, the C&AG may, in case of any company covered under sub-section (5) or sub-section (7) of section 139 of the said Act, if he considers necessary, by an order, cause test audit to be conducted of the accounts of such company and the provisions of section 19A of the Comptroller and Auditor-General's (Duties, Powers and Conditions of Service) Act, 1971, shall apply to the report of such test audit.

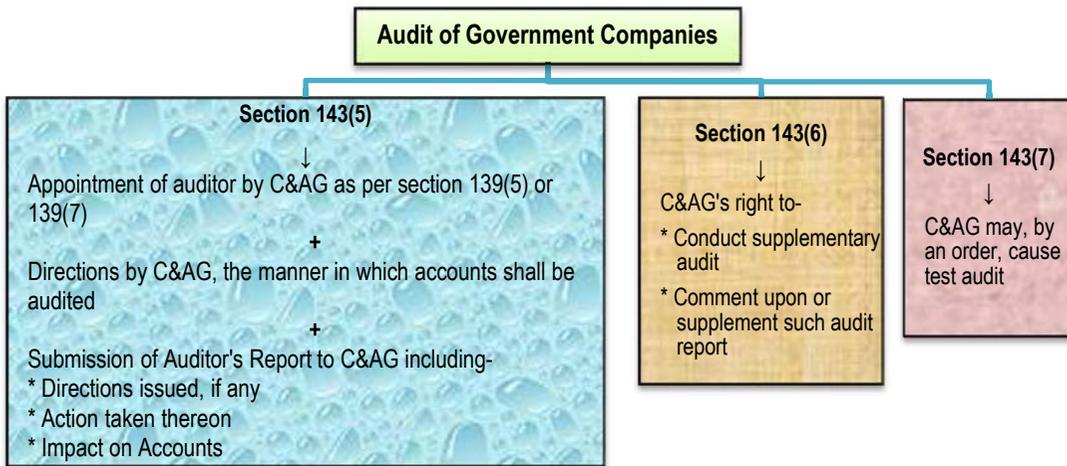


Diagram showing provisions of the Companies Act, 2013 related to Government Audit

## 5. FINANCIAL AUDIT

Financial audit is primarily conducted to:

- ✓ express an audit opinion on the financial statements; and
- ✓ enhance the degree of confidence of intended users in the financial statements.

The C&AG shall express an opinion as to whether the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework.

In the case of financial statements prepared in accordance with a fair presentation financial reporting framework, whether the financial statements are presented fairly, in all material respects, or give a true and fair view, in accordance with that framework.

## 6. COMPLIANCE AUDIT

**Compliance audit is the independent assessment of whether a given subject matter is in compliance with the applicable authorities identified as criteria.**

This audit is carried out by assessing whether activities, financial transactions and information comply in all material respects, with the regulatory and other authorities which govern the audited entity.

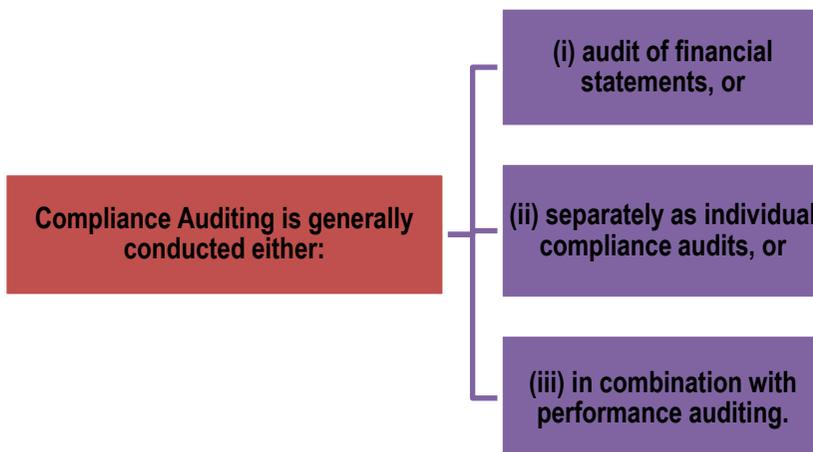
**Compliance audit is concerned with:**

- (a) **Regularity-** adherence of the subject matter to the formal criteria emanating from relevant laws, regulations and agreements applicable to the entity.
- (b) **Propriety-** observance of the general principles governing sound financial management and the ethical conduct of public officials.

While regularity is emphasized in compliance auditing, propriety is equally pertinent in the public-sector context, in which there are certain expectations concerning financial management and the conduct of officials.

**Perspective of Compliance Audit:** Compliance Audit is part of a combined audit that may also include other aspects. Compliance auditing is generally conducted either-

- (i) in relation with the audit of financial statements, or
- (ii) separately as individual compliance audits, or
- (iii) in combination with performance auditing.



## 7. PERFORMANCE AUDIT

**A performance audit is an objective and systematic examination of evidence for the purpose of providing an independent assessment of the performance of a government organization, program, activity, or function in order to provide information to improve public accountability and facilitate decision-making by parties with responsibility to oversee or initiate corrective action.**

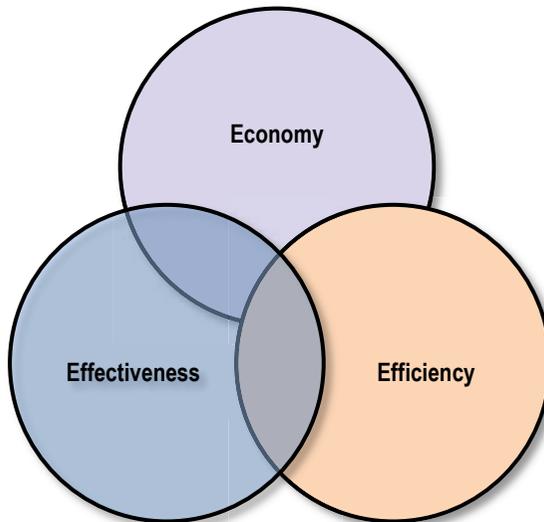
Performance audit in PSUs is conducted by the C&AG (Supreme Audit Institutions) through various subordinate offices of Indian Audit and Accounts Department (IAAD).

In conducting performance audit, the subordinate offices are guided by manual and auditing standards prescribed by C&AG.

This audit promotes accountability by assisting those charged with governance and oversight responsibilities to improve performance through an examination of whether:

- (a) decisions by the legislature or the executive are efficiently and effectively prepared and implemented; and
- (b) tax payers or citizens have received value for money.

According to the guidelines issued by the C&AG, Performance Audits usually address the issues of:



- (i) **Economy-** It is minimising the cost of resources used for an activity, having regard to appropriate quantity, quality and at the best price.

Judging economy implies forming an opinion on the resources (e.g. **human, financial and material**) deployed. This requires assessing whether the given resources have been used economically and acquired in due time, in appropriate quantity and quality at the best price.

- (ii) **Efficiency-** It is the input-output ratio. In the case of public spending, efficiency is achieved when the output is maximised at the minimum of inputs, or input is minimised for any given quantity and quality of output.

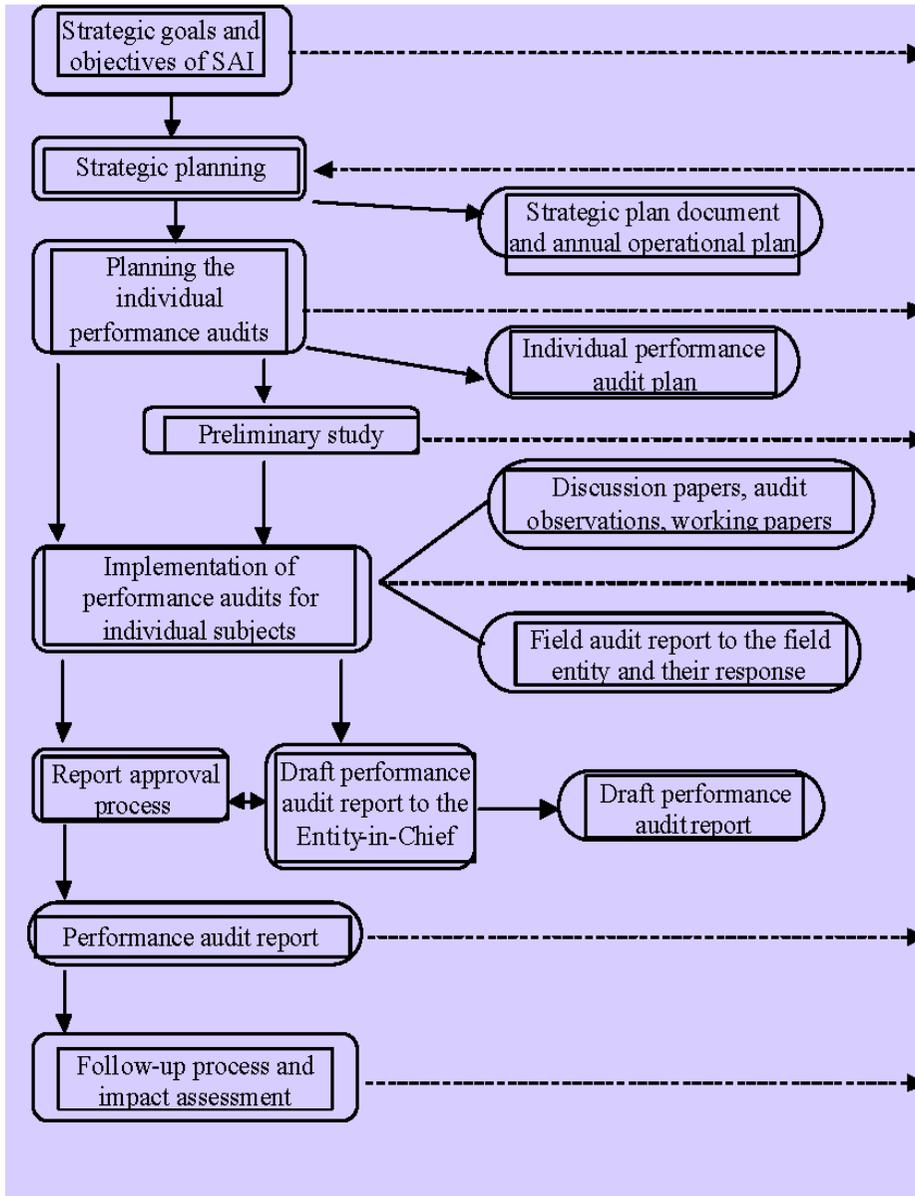
**Auditing efficiency embraces aspects such as whether:**

- (a) sound procurement practices are followed;
  - (b) resources are properly protected and maintained;
  - (c) human, financial and other resources are efficiently used;
  - (d) optimum amount of resources (staff, equipment, and facilities) are used in producing or delivering the appropriate quantity and quality of goods or services in a timely manner;
  - (e) public sector programmes, entities and activities are efficiently managed, regulated, organised and executed;
  - (f) efficient operating procedures are used; and
  - (g) the objectives of public sector programmes are met cost-effectively.
- (iii) **Effectiveness-** It is the extent to which objectives are achieved and the relationship between the intended impact and the actual impact of an activity.

**In auditing effectiveness, performance audit may, for instance:**

- (a) assess whether the objectives of and the means provided (legal, financial, etc.) for a new or ongoing public sector programme are proper, consistent, suitable or relevant to the policy;
- (b) determine the extent to which a program achieves a desired level of program results;
- (c) assess and establish with evidence whether the observed direct or indirect social and economic impacts of a policy are due to the policy or to other causes;
- (d) identify factors inhibiting satisfactory performance or goal-fulfilment;
- (e) assess whether the programme complements, duplicates, overlaps or counteracts other related programmes;
- (f) assess the effectiveness of the program and/or of individual program components;
- (g) determine whether management has considered alternatives for carrying out the program that might yield desired results more effectively or at a lower cost;
- (h) assess the adequacy of the management control system for measuring, monitoring and reporting a programme's effectiveness;
- (i) assess compliance with laws and regulations applicable to the program; and
- (j) identify ways of making programmes work more effectively.

**Performance Audit Cycle**



**7.1 Provisions contained in Companies Act, 2013 and C&AG’s (Duties, Powers, and Conditions of Service) Act, 1971**

According to section 19(1) of the Comptroller and Auditor General (Duties, Powers, and Conditions of Service) Act, 1971, the duties and powers of the Comptroller and Auditor General in relation to the audit of the Accounts of Government companies shall be performed and exercised by him in accordance with the provisions of the Companies Act.

Sub-section (6) and (7) of section 143 of the Companies Act, empowers Comptroller and Auditor General of India to conduct supplementary audit or test audit of Government companies.

**The supplementary or test audit conducted by the Comptroller and Auditor General is in the nature of efficiency-cum-performance appraisal.**

Section 143(5) of Companies Act requires the statutory auditor (chartered accountant appointed by C&AG under section 139(5) or 139(7) of the Act) to submit a copy of his audit report on the accounts of the Government company to C&AG.

Thus, section 143(6) and 143(7) of the Companies Act empowers C&AG to conduct supplementary audit and test audit respectively of annual accounts of a Government company.

In so far as statutory corporations are concerned, the respective Statutes provide for audit by C&AG. The scope includes conducting performance audit of these corporations also though specifically not stated so.

## 7.2 Objectives of Performance Auditing

The objectives of performance auditing are evaluation of economy, efficiency, and effectiveness of policy, programmes, organization and management. It also promotes accountability by assisting those charged with governance and oversight responsibilities to improve performance; and transparency by affording taxpayers, those targeted by government policies and other stakeholders an insight into the management and outcomes of different government activities.

Performance auditing focuses on areas in which it can add value which have the greatest potential for development. It provides constructive incentives for the responsible parties to take appropriate action.

### Example

#### **Performance Audit of enforcement mechanism for administering the provision of Minimum Wages Act (a social welfare legislation)**

The auditors, who undertake performance audit of a program or unit, must possess knowledge of the industries or labor contracts where these provisions are applicable and also identify the population thereof before carrying out audit program. He shall evaluate the standard of living before implementation and after implementation of the Act.

Further, the auditor shall have to evaluate the evidence available as to nature of returns prescribed and obtained for taking appropriate action.

The Performance Auditor shall also have to evaluate the economy, efficiency and effectiveness in the welfare systems to be audited. He can then study the shortcomings in the coordination between different agencies like labor department, EPF and ESI organization and the control systems and point out a set of relevant problems.

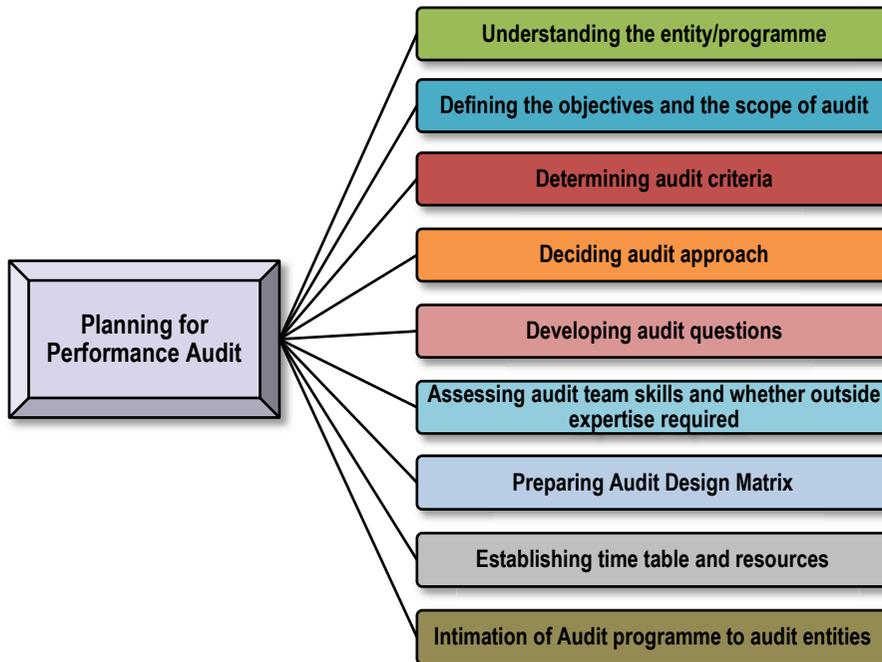
The auditor shall also have to point out lacuna, if any in the existing legal frame work or enforcement mechanism to strengthen the objective of legislation. Another possible area of critical audit may be

to study actual level of compensation required in each area keeping in mind the local living conditions and where the minimum wages prescribed in the statute is demonstrably different from this level he may report the same to the Government for taking appropriate action.

In this manner, the performance audit can not only examine the reasons for such vagaries but also ensures that the legislation serves the intended purpose. By reporting the same to the legislature, the corrective is made possible.

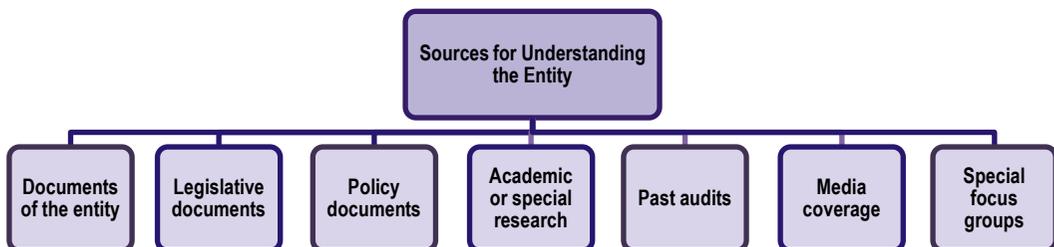
[Note: Interested students may refer to Background Material on Performance Audit of Public Sector Enterprises in India published by the CPE Committee of ICAI for further reference].

### 7.3 Planning for Performance Audit



The following steps are suggested to the auditors for planning while conducting the performance audit:

(A) **Understanding the Entity/Programme** - It is the starting point for planning individual performance audit.



**The auditor may use the following sources for understanding the entity:**

- (i) **Documents of the entity:** Documents on administration and functions of the entity, policy files, annual reports, budget documents, accounts, minutes of meetings, information on the website, internal audit reports, electronic databases and MIS reports, RTI material etc.
  - (ii) **Legislative documents:** Legislation, parliamentary questions and debates, reports of the Public Accounts Committee, the Committee on Public Undertakings, the Estimates Committee and letters from Members of Parliament.
  - (iii) **Policy documents:** Documents of Planning Commission, Ministry of Finance etc.
  - (iv) **Academic or special research:** Independent evaluations on the entity, academic research and similar work done by other governments and other SAIs.
  - (v) **Past audits:** Past financial and performance audits of the entity provide a major source of information and understanding.
  - (vi) **Media coverage:** Print and electronic media - their systematic documentation on regular basis in a transparent manner.
  - (vii) **Special focus groups:** Audit Advisory Committee concerns, annual and special reports of World Bank, Reserve Bank of India, reports by special interest groups, NGOs, etc.
- (B) **Defining the Objectives and the Scope of Audit** - The audit objectives should be defined in a succinct manner as they will impact the nature of the audit, govern its conduct and affect audit conclusions. Setting audit objectives ensures good quality performance audits. It facilitates clarity, demonstrates consistent quality of audit and serves as a measure of quality assurance of the audit.

Defining the scope constricts the audit to significant issues that relate to the audit objectives. It mainly focuses the extent, timing and nature of the audit.

- (C) **Determining Audit Criteria** - Audit criteria are the standards used to determine whether a program meets or exceeds expectations. It provides a context for understanding the results of the audit. Audit criteria are reasonable and attainable standards of performance against which economy, efficiency and effectiveness of programmes and activities can be assessed.

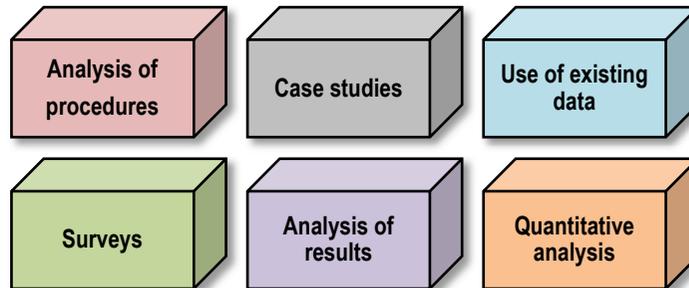
The audit criteria may be sought to be obtained from the following sources:

- (i) procedure manuals of the entity.
- (ii) policies, standards, directives and guidelines.
- (iii) criteria used by the same entity or other entities in similar activities or programmes.
- (iv) independent expert opinion and know how.

- (v) new or established scientific knowledge and other reliable information.
- (vi) general management and subject matter literature and research papers.

**(D) Deciding Audit Approach** - There is no uniform audit approach prescribed that can be applicable to all types of subjects of performance audits. Selection of approach also determine methods and means used for conducting the audit.

Some of the methods which could be used in conducting performance audits include:



- (i) **Analysis of procedures:** It involves review of the systems in place for planning, conducting, checking and monitoring the activity. This would consist of examination of documents such as financial reports, budgets, programme guidelines, procedure manuals, etc.
- (ii) **Case studies:** A case study is a descriptive analysis of an entity, scheme or a programme. It involves analysis of a particular issue within the context of the whole area under review.
- (iii) **Use of existing data:** The audit staff should investigate the data held by entity management and by other relevant sources. Audit conclusions based on testing of available data for correctness and completeness enhances the assurance level.
- (iv) **Surveys:** Survey is a method of collecting information from members of a population to assess the interrelation of events and conditions. Surveys on predetermined parameters can supplement the audit findings and conclusions adding value to the performance audits.
- (v) **Analysis of results:** It requires the auditor to carry out actual output-input analysis to determine the efficiency of the programme.
- (vi) **Quantitative analysis:** It involves examination of available data relating to financials like earnings, revenue, or data relating to programme implementation like details of beneficiaries etc. However, it may not be possible for the auditor to work with complete data due to its high volume. In such cases, sampling techniques are required to be used.

- (E) **Developing Audit Questions** - Subsequent to designing of audit objectives and determination of audit criteria, the audit team is required to prepare a list of questions to which they would seek answers. The questions should be framed in comprehensive manner involving detailed hierarchy of questions.
- (F) **Assessing Audit Team Skills and whether Outside Expertise required** - It is essential that the performance auditors possess special aptitude and knowledge. The Auditing Standards of C&AG of India provide that the audit institution should develop and train the auditors to enable them to perform their tasks effectively & efficiently and should prepare manuals & other written guidance notes & instructions concerning conduct of audits.

Given the diverse range of subjects of performance auditing, the audit team needs to develop sound understanding of the programme or entity proposed to be audited.

The audit team needs to decide at the planning stage on which aspect expertise is required. Though, the Accountant General may use the work of an expert, he retains full responsibility for the expression of opinion in the auditor's report.

- (G) **Preparing Audit Design Matrix (ADM)** - Having determined the audit objective, audit criteria, audit approach, data collection etc., audit team should prepare an Audit Design Matrix. It is a structured and highly focused approach to designing a performance audit study.

The ADM highlights the data collection and analysis method as well as the type and sources of evidence required to support audit opinion/findings.

**A specimen of ADM is given as under:**

Audit Objective	Audit Questions	Audit Criteria	Evidence	Data Collection and Analysis Method
(1)	(2)	(3)	(4)	(5)

An ADM is prepared on the basis of information and knowledge obtained during the planning stage. A well-designed ADM leads to effective audits thus providing highest assurances to the auditing entities. It is desirable to prepare ADM for each of the audit objectives.

- (H) **Establishing Time Table and Resources** - It is significant to determine the timetable and desirable resources. Selection of appropriate audit team is the most vital component in planning an audit. Considerations for selection of an appropriate audit team should be recorded along with the proposed timelines for various activities to be undertaken as a part of audit process. The progress should also be monitored against these timelines. The Accountant General would be liable for ensuring that the performance audit is completed on time. The variations between the required and actual time spent should be compared and approved from the competent authority.

The team should build time for translation, approval and possible delays in their own schedule in order to meet the targets.

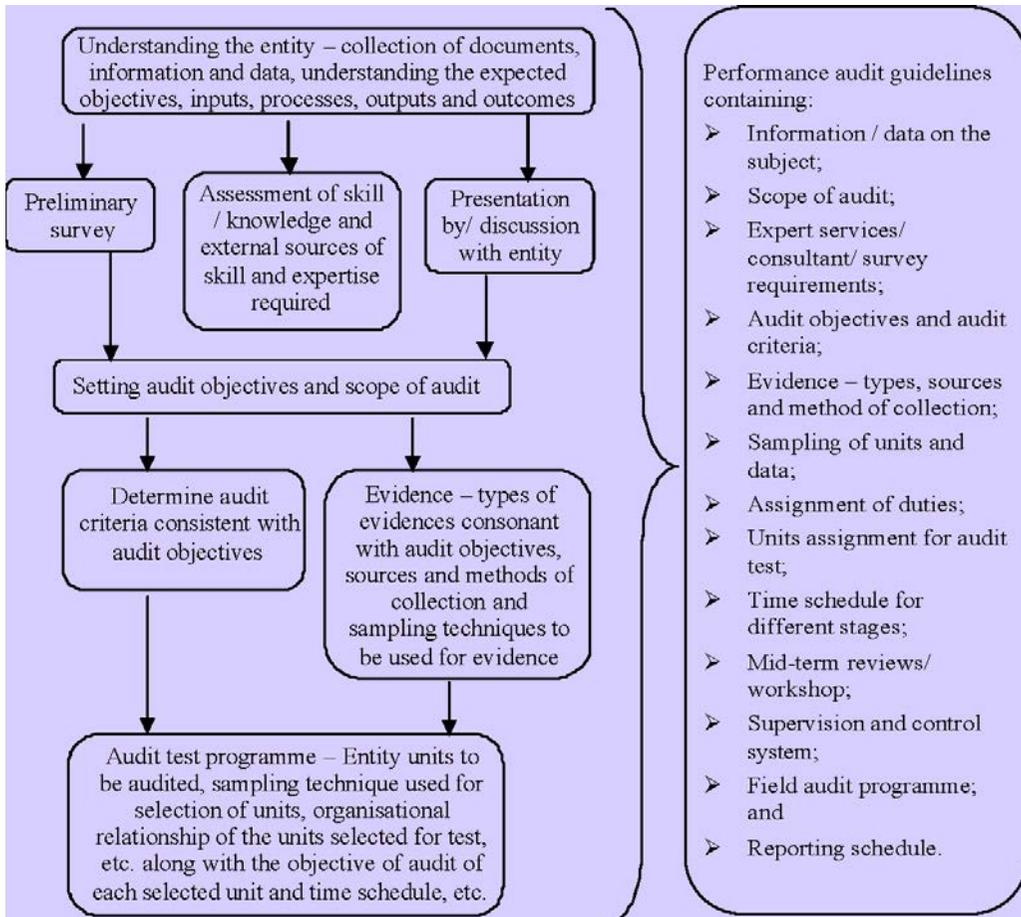
- (I) **Intimation of Audit Programme to Audit Entities** - Audited entities must be intimated about the intention of taking up planned performance audit with the scope and extent of audit including the constitution of audit team and the tentative time schedule, well before the commencement of Audit. Acknowledgement of this may be requested and placed on record.

It may be required to refine an audit's objectives as the audit progresses for gathering the requisite information to fulfill the audit. The reasons for such changes in the objectives should also be recorded and approved from the competent authority.

The audit programme should be flexible and reviewed from time to time as it is not possible to anticipate all the contingencies at the early stage.

The Accountant General should share all significant refinements in the approach and additional tests and findings, concurrently with other audit teams when different persons conduct the audit at different locations. The system of sharing of the significant field audit experience should be documented and reviewed.

**Performance Audit Planning**



**Specimen (abridged) Performance Report issued by  
the Comptroller and Auditor General of India**

**I. Performance Audit on functioning of Internal Audit in Income Tax Department for the year ended March, 2015**

This Report for the year ended March, 2015 has been prepared for submission to the President under Article 151 of the Constitution of India.

Income Tax Department (ITD) is subjected to Internal Audit of assessment and accounting functions. The audit objectives of the "Functioning of Internal Audit Wing in Income Tax Department" were to derive an assurance whether:

- (a) Internal audit is effective in providing reasonable assurance to the CBDT and Senior Management regarding achievement of objectives relating to compliance, assessment and other interrelated activities, as determined by CBDT.
- (b) Internal audit is playing an effective role in enhancing the quality of assessments.
- (c) There is an effective and efficient follow-up mechanism of internal audit findings and recommendations.

We examined the control issues relevant to CIT (Audit) charges and monitoring mechanism at the level of DIT (Audit) as well as Regional Supervisory Authorities administering the CIT (Audit) charges.

We found that Action Plan was not prepared in 17 CIT (Audit) charges. We noticed that list of auditable cases were not received on a regular basis in 19 CsIT (Audit) charges from administrative CsIT under Pr. CCsIT/CCsIT of 12 regions.

We noticed that out of 7,00,398 cases assigned, Internal Audit examined only 5,73,457 cases resulting in shortfall in coverage of 1,26,941 cases. The practice of selection of high risk units is not in place.

We found that there were delays in initiation of remedial action in 6,172 cases (13 regions) and delays in completion of remedial action in 1,640 cases (10 regions). We noticed 73 cases involving tax effect of ₹ 134.10 crore in six regions where Internal Audit objections were settled without proper reply or completion of remedial action. Inadequate follow up of Internal Audit objections resulted in time barring of 1,553 cases involving tax effect of ₹ 392.65 crore in 11 CsIT (Audit) charges.

The audit has been conducted in conformity with the Auditing Standards issued by the Comptroller and Auditor General of India.

Audit wishes to acknowledge the cooperation received from the Department of Revenue - Central Board of Direct Taxes at each stage of the audit process.

**II. Performance of 100% Export Oriented Unit (EOU) scheme of Department of Revenue-Indirect Taxes, Customs for the year ended March, 2014**

This Report for the year ended March, 2014 has been prepared for submission to the President of India under Article 151 of the Constitution of India.

**A Performance Audit on the working of the EOU, corresponding to the Foreign Trade Policy (2009-14), was conducted with a view to seek an assurance that:**

- (a) there exists adequate statutory provision/rules regulation, instructions/notification with regards to approval, creation, functioning and monitoring of EOUs.
- (b) the EOUs fulfilled the import conditions as laid down in the relevant notifications and FTP and applicable provisions of HBP.
- (c) the EOUs were able to fulfill the intended objectives as stated in the Foreign Trade Policy.
- (d) the internal controls system and monitoring mechanism are effective.

The total number of EOUs has gone down from 3109 in 2009-10 to 2608 in 2013-14. While the number of functional units has come down from 2279 to 2095 during the same period, the percentage of functional units to total units has declined from 83 per cent in 2010-11 to 80 per cent in 2013-14 with corresponding increase in percentage of non-functional and deboned units. There has been a gradual reduction in EOUs after the SEZ Act came into force in 2006-07.

Government of India had forgone significant customs revenue amounting to ₹ 32,932 crore during 2009-10 to 2013-14 on EOU/EHTP/STP schemes. Government has fallen short by almost 33 per cent (US\$ 150 billion) of its export target in 2013-14 vis-a-vis its Strategic Plan (DoC).

Audit wishes to acknowledge the cooperation received from Ministry of Commerce and Industry (DoC) and Department of Revenue (DoR) and its field formations at each stage of the audit process.

## 8. COMPREHENSIVE AUDIT

The Comptroller and Auditor General assists the legislature in reviewing the performance of public undertakings. He conducts an efficiency-cum-performance audit other than the field which has already been covered either by the internal audit of the individual concerns or by the professional auditors. He locates the area of weakness and extravagance for managements' information.

The areas covered in comprehensive audit naturally vary from enterprise to enterprise depending on the nature of the enterprise, its objectives and operations. However, in general, the covered areas are those of investment decisions, project formulation, organisational effectiveness, capacity utilisation, management of equipment, plant and machinery, production performance, use of materials, productivity of labour, idle capacity, costs and prices, materials management, sales and credit control, budgetary and internal control systems, etc.

**Some of the issues examined in comprehensive audit are:**

- (a) How does the overall capital cost of the project compare with the approved planned costs? Were there any substantial increases and, if so, what are these and whether there is evidence of extravagance or unnecessary expenditure?
- (b) Have the accepted production or operational outputs been achieved? Has there been under-utilisation of installed capacity or shortfall in performance and, if so, what has caused it?

- (c) Has the planned rate of return been achieved?
- (d) Are the systems of project formulation and execution sound? Are there inadequacies? What has been the effect on the gestation period and capital cost?
- (e) Are cost control measures adequate and are there inefficiencies, wastages in raw materials consumption, etc.?
- (f) Are the purchase policies adequate? Or have they led to piling up of inventory resulting in redundancy in stores and spares?
- (g) Does the enterprise have research and development programmes? What has been the performance in adopting new processes, technologies, improving profits and in reducing costs through technological progress?
- (h) If the enterprise has an adequate system of repairs and maintenance?
- (i) Are procedures effective and economical?
- (j) Is there any poor or insufficient or inefficient project planning?

The Bureau of Public Enterprises has issued guidelines to be followed by the public sector enterprises in respect of general management, financial management, materials management, production management, construction management, etc. and these guidelines provide another basis for appraising enterprise performance and its systems. Another source of criteria is industrial engineering and other technical studies by internal and external experts and the standards given in these. Then there are standards of financial propriety.

The starting point of a comprehensive appraisal 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.

## 9. PROPRIETY AUDIT

Auditing, as a composite concept, looks into accounting and arithmetical accuracy, adherence to applicable rules and regulations, propriety and the "truth and fairness" of the end result. According to the varied requirements, the emphasis on each of the aforesaid factors differs between various types of audit. All the requirements of section 143 of the Companies Act, 2013 are also applicable to a Government Company. The analysis that follows shows that some of the provisions of section 143 really are propriety based. In addition, the Companies (Auditor's Report) Order, 2016 issued

under section 143(11) of the Companies Act is also applicable to a Government Company, provided the Government Company belongs to any of the categories of companies to which the Order applies. Propriety aspects in an audit already exists in the audits carried on by the C&AG.

## 9.1 Definition and Principles

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”.**

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.

In 'propriety audit', the auditors try to bring out cases of improper, avoidable, or infructuous expenditure even though the expenditure has been incurred in conformity with the existing rules and regulations. A transaction may satisfy all the requirements of regularity audit insofar as the various formalities regarding rules and regulations are concerned, but may still be highly wasteful.



For example, a building may be constructed for installing a telephone exchange but may not be used for the same purpose resulting in infructuous expenditure or a school building may be constructed but used after five years of its completion is a case of avoidable expenditure.

Audit should, therefore, try to secure a reasonably high standard of public financial morality by looking into the wisdom, faithfulness and economy of transactions. These considerations have led to the evolution of audit against propriety which is now being combined by the audit authorities with their routine function of regularity audit. It is hard to frame any precise rules for regulating the course of audit against propriety. Such an objective of audit depends for its acceptance on its appeal to the common sense and straight logic of the auditors and of those whose financial transactions are subjected to propriety audit. However, some general principles have been laid down in the Audit Code, which have for long been recognised as standards of financial propriety.

**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.

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

## **9.2 Relevant Provisions in the Companies Act, 2013**

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

1. Section 143(1) requiring enquiry into certain specified matters.
2. Section 143(6) and 143(7) requiring a supplementary audit and test audit respectively in respect of the Government companies on matters specified.
3. Section 148 relating to Cost Records and Audit.
4. Additional information in Part II of Schedule III.

All these are applicable to Government Companies. The requirement of the provisions of section 143(1) is essentially propriety-oriented as much as some specific dubious practices are required to be looked into by the auditor. Areas of propriety audit under the provisions of Section 143(1) may be following:

- (a) **Whether the terms on which secured loans and secured advances have been made are prejudicial to the interests of the company or its members.**

It may be appreciated that the terms of loans include such matters as security, interest, repayment period and other business considerations. The auditor has to inquire whether the terms are such that they can be adjudged as prejudicial to the legitimate interest of the company or of its shareholders. This is a process of judging a situation by reference to certain objective standards or reasonableness whether the terms entered into are prejudicial or not, not only to the company but also to the shareholders.

- (b) **Whether transactions of the company which are represented merely by book entries are prejudicial to the interests of the company.**

This proposition has got to be inquired into by reference to the effects of the book entries, unsupported by transactions, on the legitimate interests of the company. The auditor has to exercise his judgment based on certain objective standards. It is also possible that some transactions may not adversely affect the interests of the company. The auditor has to judiciously consider what does and does not constitute the interest of the company.

- (c) **Whether investment of companies, other than a banking or an investment company, in the form of shares, debentures and other securities have been sold at a price lower than the cost.**

Apparently, this is a matter of verification by the auditor. The intention, however, is not known whether loss has occurred due to the sale. The auditor is required to inquire into circumstances of sale of investments that resulted in loss. Obviously, the duty cast on him is propriety based, i.e., reasonableness of the decision to sell at a loss. It involves exercise of judgment having regard to the circumstances in which the company was placed at the time of making the sale.

- (d) **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.**

- (e) **Whether personal expenses have been charged to revenue.**

It is an accepted principle that expenses which are not business expenses should not be charged to revenue. The effect of charging personal expenses to the business is to distort the profitability of the company and to secure a personal gain at the cost of the company. Obviously, propriety is involved in this; charging personal expenses to business account is highly improper and abusive hence this provision.

- (f) **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.

Cost records and the provisions of cost audit are designed to inculcate cost consciousness in the management and to know whether productivity is of acceptable order and whether undue wastage or loss etc. has occurred. It would be useful to go into some of the specific requirement of cost audit report in this context. Some of the matters in the additional information sought through the Statement of Profit and Loss (i.e., Part II of Schedule III) provide a basis for making more searching enquiries

into such vital matters as consumption of raw materials under broad heads, goods purchased under broad heads, work in progress under broad heads, any item of income or expenditure which exceeds one percent of the revenue from operations or ₹ 1,00,000, whichever is higher, etc.

The implications of the Companies (Auditor's Report) Order, 2016 and the provisions of the section 143(6) and the directions issued by the Comptroller and Auditor General also contain significant elements of propriety.

### 9.3 Propriety Elements under CARO, 2016

- (a) If the company has granted any loans, secured or unsecured, to companies, firms limited liabilities partnerships or other parties covered in the register maintained under section 189 of the Companies Act, whether the terms and conditions of the grant of such loans are not prejudicial to the company's interest, whether the repayment of the principal amount and interest are stipulated and whether repayments or receipts are regular. For this, the auditor should take note of repayment schedule. If loan agreements are not executed, any other equivalent documents may be referred to arrive at the terms of receipt of interest, for example, letters of understanding, acknowledgement by the party of the terms and conditions communicated by the company, etc. The dates of receipt of principal amount and interest thereof needs to be verified with reference to the books of accounts of the company to come to the conclusion whether such receipts are regular.
- (b) If the amount is overdue, state the total amount overdue for more than ninety days, and whether reasonable steps have been taken by the company for recovery of the principal and interest. In making this examination, the auditor would have to consider the facts and circumstances of each case, including the amounts involved. It is not necessary that steps to be taken must necessarily be legal steps. Depending upon the circumstances, period of delay and other similar factors, issue of reminders or sending of advocate's or solicitor's notice may amount to reasonable steps. The auditor should ask the management to give in writing the steps which have been taken. The auditor should arrive at his opinion only after consideration of the management's representations.
- (c) In respect of loans, investments, guarantees, and security whether provisions of section 185 and 186 of the Companies Act, 2013 have been complied with. If not, provide the details thereof.
- (d) Whether maintenance of cost records has been specified by the Central Government under section 148(1) of the Companies Act, 2013 and whether such accounts and records have been so made and maintained.
- (e) Whether the company is regular in depositing undisputed statutory dues including provident fund, employees' state insurance, income-tax, sales-tax, service tax, duty of customs, duty of excise, value added tax, cess and any other statutory dues to the appropriate authorities and if not, the extent of the arrears of outstanding statutory dues as on the last day of the

financial year concerned for a period of more than six months from the date they became payable, shall be indicated; by the auditor. In addition, where dues of income tax or sales tax or service tax or duty of customs or duty of excise or value added tax have not been deposited on account of any dispute, then the amounts involved and the forum where dispute is pending shall be mentioned by the auditor. It may be noted that mere representation to the concerned Department shall not be treated as a dispute.

- (f) If the company has defaulted in repayment of loans or borrowing to a financial institution, bank, Government or dues to debenture holders? If yes, the period and the amount of default to be reported (in case of defaults to banks, financial institutions, and Government, lender wise details to be provided). The auditor should obtain a schedule of repayments to banks, financial institutions and debenture holders from the management of the company. He should examine the agreement or other documents containing the terms and conditions of the loans and borrowings of the company from banks and financial institutions. The auditor should also examine the debenture trust deed. This examination would enable the auditor in verifying the amount and due dates of the payments mentioned in schedule of repayments provided by the management of the company. The auditor should then verify whether the repayments as per the books of account are in accordance with the terms and conditions of the relevant agreement. The auditor should also satisfy himself that the repayment have actually been made to the party concerned.
- (g) Whether the term loans were applied for the purpose for which the loans were obtained. The auditor should examine the terms and conditions subject to which the company has obtained the term loans. The auditor may also examine the proposal for grant of loan made to the bank. The auditor should compare the purpose for which term loans were sanctioned with the actual utilisation of the loans. He should obtain sufficient appropriate audit evidence regarding the utilisation of the amounts raised.
- (h) Whether moneys raised by way of initial public offer or further public offer (including debt instruments) and term loans were applied for the purposes for which those are raised. If not, the details together with delays or default and subsequent rectification, if any, as may be applicable, be reported;
- (i) Whether any fraud by the company or any fraud on the Company by its officers or employees has been noticed or reported during the year; If yes, the nature and the amount involved is to be indicated;

For this, while planning the audit, the auditor should discuss with other members of the audit team, the susceptibility of the company to material misstatements in the financial statements resulting from fraud. The auditor should examine the reports of the internal auditor with a view to ascertain whether any fraud has been reported or noticed by the management. The auditor should examine the minutes of the audit committee, if available, to ascertain whether any instance of fraud pertaining to the company has been reported and actions taken thereon. The auditor should also discuss the matter with other employees of the company.

This reporting for any fraud committed by the company is in addition to the reporting required under section 143(12) wherein the auditor has to directly report to the central government on certain types of frauds.

- (j) Whether managerial remuneration has been paid or provided in accordance with the requisite approvals mandated by the provisions of section 197 read with Schedule V to the Companies Act? If not, state the amount involved and steps taken by the company for securing refund of the same;
- (k) Whether the Nidhi Company has complied with the Net Owned Funds to Deposits in the ratio of 1: 20 to meet out the liability and whether the Nidhi Company is maintaining ten per cent unencumbered term deposits as specified in the Nidhi Rules, 2014 to meet out the liability;
- (l) Whether the company has made any preferential allotment or private placement of shares or fully or partly convertible debentures during the year under review and if so, as to whether the requirement of section 42 of the Companies Act, 2013 have been complied with and the amount raised have been used for the purposes for which the funds were raised. If not, provide the details in respect of the amount involved and nature of non-compliance;
- (m) Whether the company has entered into any non-cash transactions with directors or persons connected with him and if so, whether the provisions of section 192 of Companies Act, 2013 have been complied with;

From the above analysis, it is clear that under the Companies Act, we already have tools which bring about a blending of propriety audit. However, a word of caution is necessary in this context. The audit conducted by the C&AG is a rule, procedure and propriety-based one; and often it is said that the desired flexibility is lacking in the system and this has contributed in a large measure to the lack of rapport between the auditor and the audit-units. Honesty is open to question, if that honesty has deviated from laid down rules and procedures. In turn, this has tended to foster a tendency amongst Government officials to just conform to the rules and provide a show of compliance with the standards of propriety. This is not intended to be little the contribution of this audit in ensuring appropriate use of fund of the Government. In Government, because of the enormous amounts involved and the massive volume of transactions and in view of public interest, it is but necessary that compliance with rules should be insisted upon and non-compliance enquired into. But the benefit derived is at least partly offset by the element of distrust and often the truth remains buried.

As mentioned earlier, excepting the directions of the C&AG under the Companies Act, the rest of the provisions are applicable equally to Government and Non-Government companies. Whatever elements of propriety are discernible in them are also present in the audit of Non-Government companies. The directions generally known as C&AG's directions, however, are exclusively applicable to the audit of Government companies.

**Propriety Audit-Problems** - 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. In propriety audit the formulation of verifiable auditing propositions poses the problem.

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.

The norms so developed provide the basis of verifying expenditure incurred by various Government departments. It may be appreciated that the norms of propriety applicable to governmental transactions may not *ipso facto* apply to transactions of private sector which have distinct and more limited, objectives suited to them. Each private sector entity may have its unique objectives related, to its management philosophy and the transactions should be geared to achieve those. For example, a management which is operating for maximization of profits without infringing, any legal regulations may follow certain policies while another management believing in a wider measure of social justice may follow different policies. Despite these clear angularities, certain commonness can also be discerned in the policies and approaches of different managements. They include efficient operations, higher productivity and higher profit, reduction of wasteful expenditure etc. Above all, each entity has its impact on the society and building up propriety audit propositions becomes of paramount importance.

It is felt that if the management of each entity, irrespective of any legal requirements, formulates norms of propriety for the entity, taking full note of wider social repercussions inherent in its operations; a formidable hurdle in the way of wider introduction of propriety audit can be removed. The element of subjectivity in propriety evaluation will get reduced.

Propriety as a moral element should be a matter of evaluation based on objectives and prevailing circumstances. For example, a travel by air as such should not be considered wasteful unless it is proved that a travel by rail would have been feasible in the circumstances and would have brought the same results brought by the air travel.

The element of subjectivity has sometimes resulted in proper discharge of duty very delicate and which 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 not on hindsight) and therefore, the auditor in his field must reconstruct such circumstances. The judgment 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.



## 10. AUDIT REPORT OF THE COMPTROLLER AND AUDITOR GENERAL

To facilitate a proper consideration, the reports of the C&AG on the audit of PSUs are presented to the Parliament in several parts consisting of the following:

- (a) Introduction containing a general review of the working results of Government companies, deemed Government companies and corporations;
- (b) Results of comprehensive appraisals of selected undertakings conducted by the Audit Board;
- (c) Resume of the company auditors' reports submitted by them under the directions issued by the C&AG and that of comments on the accounts of the Government companies; and
- (d) Significant results of audit of the undertakings not taken up for appraisal by the Audit Board.

For certain specified states, the C&AG submits a separate audit report (commercial) to the legislature, while for other States/Union Territories with legislature, there is a commercial chapter in the main audit report. The State audit reports, contains both the results of audit appraisal of performance of selected companies/corporations as well as important individual instances of financial irregularities, wasteful expenditure, system deficiencies noticed by the statutory auditors, comments noticed in Government audit in the audit functions of certification of accounts and a general review of the working results of Government companies and corporations.

### TEST YOUR KNOWLEDGE

#### Theoretical Questions

1. What are the principles involved regarding "Propriety audit" in the case of Public Sector Undertaking?
2. Write a short explanatory note on –
  - (a) Areas of propriety audit under Section 143(1) of the Companies Act, 2013.
  - (b) Role of C&AG in the Audit of a Government company.
3. ABG & Co., a Chartered Accountant firm has been appointed by C & AG for performance audit of a Sugar Industry. What factors should be considered by ABG & Co., while planning a performance audit of Sugar Industry?

#### Multiple Choice Questions

1. Setir Ltd is a company in which 59% of the paid up share capital is held by Punjab Government. The company is engaged in the business of providing consultancy services in relation to construction projects.

The Punjab Government is also planning to induct funds in the company in future, if required.

Nocri Ltd is a company controlled by Setir Ltd. The business of Nocri Ltd is construction and has an annual turnover of INR 2500 crores approx.

The audit of the financial statements of Nocri Ltd for the financial year ended 31 March 2019 got completed but Nocri Ltd observed that during the course of audit, there was lot of intervention of Comptroller & Auditor General of India, wherein C&AG was giving directions to the auditors on the manner in which audit should be conducted in respect of certain areas.

Further, it also received comments from C&AG on the audit report of the auditors. Nocri Ltd is seeking legal opinion to go against C&AG so that they can avoid unnecessary interference of C&AG and is also looking to have new auditors appointed by Nocri Ltd with whom they will have an engagement letter with the terms that those auditors don't accept any interference of C&AG which the existing auditors have not been able to avoid.

In this context, please advise which of the following should be correct?

- (a) The stand of the existing auditors should have been better i.e. not to accept any interference of C&AG.
- (b) Management could have planned the audit work better by including the same terms in engagement letter with existing auditors instead of appointing another auditors.
- (c) C&AG involvement could have been accepted if this was the audit of Setir Ltd but not in case of Nokri Ltd and hence Nokri Ltd should also reach out to its parent company to get this resolved.
- (d) Stand of Nokri Ltd is wrong as the C&AG may get involved in the audit of Nokri Ltd.

2. CGN Ltd is a large company engaged in the business of oil exploration in India. The Tamil Nadu Government and the Central Government hold 37% and 20% respectively of the paid up share capital of this company.

The C&AG appointed the statutory auditors of this company as per requirements of the Companies Act 2013. The company had a concern regarding this appointment because company wanted to appoint another auditors as per their assessment, however, considering the legal hassles which would have got involved, the company decided to go ahead with this.

The audit of the financial statement for the year ended 31 March 2019 got completed by the auditors appointed by the C&AG. Subsequent to this, the C&AG also issued an order to conduct test audit of the accounts of the company which was objected by the management of the company.

The management objected saying that the complete set of financial statements have been audited by auditors appointed by the C&AG and hence this order is not acceptable because this would lead to duplication of work.

Moreover, the management has also written to the C&AG that for the next financial year, the existing auditors should either resign so that the management may bring in their own auditors

or the C&AG should have faith in the work of the auditors appointed by them. Please suggest how to resolve this matter.

- (a) The management's stand is not correct. The C&AG may order test audit as per the requirements of the Companies Act 2013.
- (b) The management's stand is not correct. The C&AG may order test audit as per the requirements of the Indian Penal Code.
- (c) The management is correct and in this situation they get the right to appoint another auditor considering the fact that the C&AG has lost faith in the work of auditors appointed by them.
- (d) Such type of matters should be taken to arbitration as per the requirements of the Arbitration Act.

3. NOP Ltd is a joint venture of Central Government and a private company and is engaged in the business of distribution of electricity in Chennai. The Central Government holds 51% shares of the company.

The company is acknowledged for its consumer-friendly practices. Initially it was completely owned by the Government and was running into significant losses but after the joint venture, the aggregate technical and commercial losses of the company showed a record decline.

The operations of the company have improved significantly as claimed by the management of the company.

The C&AG wants to conduct the performance audit of one of the departments of the company through a subordinate office of Indian Audit and Accounts Department.

For this purpose, the audit programme has also been finalized and the Accountant General has intimated the company that the audit would start within a day's time. The company is concerned because the programme which has been received from the Accountant General is quite detailed and would involve significant time. Further the management of the company is quite surprised as to why this audit should be conducted as this is not a company subject to such types of audits as per law.

The management of the company would like to have your inputs in respect of this matter. Please guide.

- (a) The notice for such type of audit should give reasonable time to the management to prepare themselves. Further it should not be a detailed audit requiring significant time of the company.
- (b) The C&AG may conduct such type of audits in respect of NOP Ltd which would get covered in this criteria, however, the notice for conducting such type of audit should give reasonable time to the management to prepare themselves.

- (c) In case of a joint venture such type of audit cannot be performed as per the Companies Act 2013. The company should write to the Registrar of Companies in respect of this matter and till that time no audit can be started.
  - (d) In case of a joint venture such type of audit cannot be performed as per the Companies Act 2013. Further wherever this is applicable that is only for a small period of time. The company should write to the Ministry of Corporate Affairs in respect of this matter.
4. AJ Petroleum & Refining Ltd is a Maharatna Central Public Sector Undertaking (PSU) in India having its registered office in Uttranchal.

It is engaged in the business of oil refining, pipeline transportation & marketing, exploration & production of crude oil & gas, petrochemicals, gas marketing and other downstream operations.

The PSU has global aspirations for which its management is working on various plans/programmes so that the same can be achieved in future. It is also planning to pursue diverse business interests by setting up of various joint ventures with reputed business partners from India and abroad to explore global opportunities.

Considering these objectives and other factors, the C&AG directed the performance audit in respect of its certain activities/ functions which has been in progress. Before starting the audit, the detailed scope and composition of audit team was shared with the management of the company and tentative timelines were also given with which the management was fine. However, during the course of the audit the audit team changed its audit programme to achieve the desired objectives which was approved by the competent authority, however, the management was not happy with those changes.

The management wants the audit team to conclude the audit with the same scope as this is a special type of audit wherein such flexibility cannot be accepted as that would defeat the purpose of the law. However, the audit team has a different view. Please guide.

- (a) Changes in audit programme in such type of audits are not acceptable as specified by the Companies Audit and Auditors Rules 2014.
- (b) Changes in audit programme in such type of audits are not acceptable as specified by the Companies Audit and Auditors Rules 2014 and the Ministry of Law.
- (c) Changes in audit programme in such type of audits can be accepted provided those are discussed with the management and approved by the Competent Authority.
- (d) The C&AG should get involved in this matter after taking permission from the Central Government and would require to change the audit team if the scope requires any changes as the same should have been properly assessed by the audit team before commencing the audit.

5. In Case of PSU, Direct Reporting Engagement does not include
- (a) Performance audits
  - (b) Compliance audits
  - (c) Financial audits
  - (d) Comprehensive Audit

### Answers to Theoretical Questions

1. Companies Act, lays down special provisions regarding audit of accounts of public sector undertakings registered as Government Companies. Section 143 of the Companies Act, 2013 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 fulfill 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.

2. (a) **Areas of Propriety Audit under Section 143(1):** Section 143(1) of the Companies Act, 2013 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 prejudicial to the interests of the company or its members;
- (ii) whether transactions of the company which are represented merely by book entries are prejudicial to the interests of the company; Again, considering the propriety element, rationalizing the proper disclosure of loans and advance given by company is made;
- (iii) where the company not being an investment company 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;
- (v) whether personal expenses have been charged to revenue account;
- (vi) where it is stated in the books and documents of the company that any shares have been allotted for cash, whether cash has actually been received in respect of such allotment, and if no cash has actually been so received, whether the position as stated in the account books and the balance sheet 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.

- (b) **Role of C&AG in the Audit of a Government company:** Role of C&AG is prescribed under sub section (5), (6) and (7) of section 143 of the Companies Act, 2013.

In the case of a Government company, the comptroller and Auditor-General of India shall appoint the auditor under sub-section (5) or sub-section (7) of section 139 i.e. appointment of First Auditor or Subsequent Auditor and direct such auditor the manner in which the accounts of the Government company are required to be audited and

thereupon the auditor so appointed shall submit a copy of the audit report to the Comptroller and Auditor-General of India which, among other things, include the directions, if any, issued by the Comptroller and Auditor-General of India, the action taken thereon and its impact on the accounts and financial statement of the company.

The Comptroller and Auditor-General of India shall within sixty days from the date of receipt of the audit report have a right to:

- (i) conduct a supplementary audit of the financial statement of the company by such person or persons as he may authorize in this behalf; and for the purposes of such audit, require information or additional information to be furnished to any person or persons, so authorised, on such matters, by such person or persons, and in such form, as the Comptroller and Auditor-General of India may direct; and
- (ii) comment upon or supplement such audit report.

It may be noted that any comments given by the Comptroller and Auditor-General of India upon, or supplement to, the audit report shall be sent by the company to every person entitled to copies of audited financial statements under sub-section (1) of section 136 i.e. every member of the company, to every trustee for the debenture-holder of any debentures issued by the company, and to all persons other than such member or trustee, being the person so entitled and also be placed before the annual general meeting of the company at the same time and in the same manner as the audit report.

**Test Audit:** Further, without prejudice to the provisions relating to audit and auditor, the Comptroller and Auditor-General of India may, in case of any company covered under sub-section (5) or sub-section (7) of section 139, if he considers necessary, by an order, cause test audit to be conducted of the accounts of such company and the provisions of section 19A of the Comptroller and Auditor-General's (Duties, Powers and Conditions of Service) Act, 1971, shall apply to the report of such test audit.

3. Factors to be considered while planning the Performance Audit: Refer Para 7.3.

### Answers to Multiple Choice Questions

1. (d)
2. (a)
3. (b)
4. (c)
5. (c)