CHAPTER 15

OVERVIEW OF AUDIT OF PUBLIC SECTOR UNDERTAKINGS



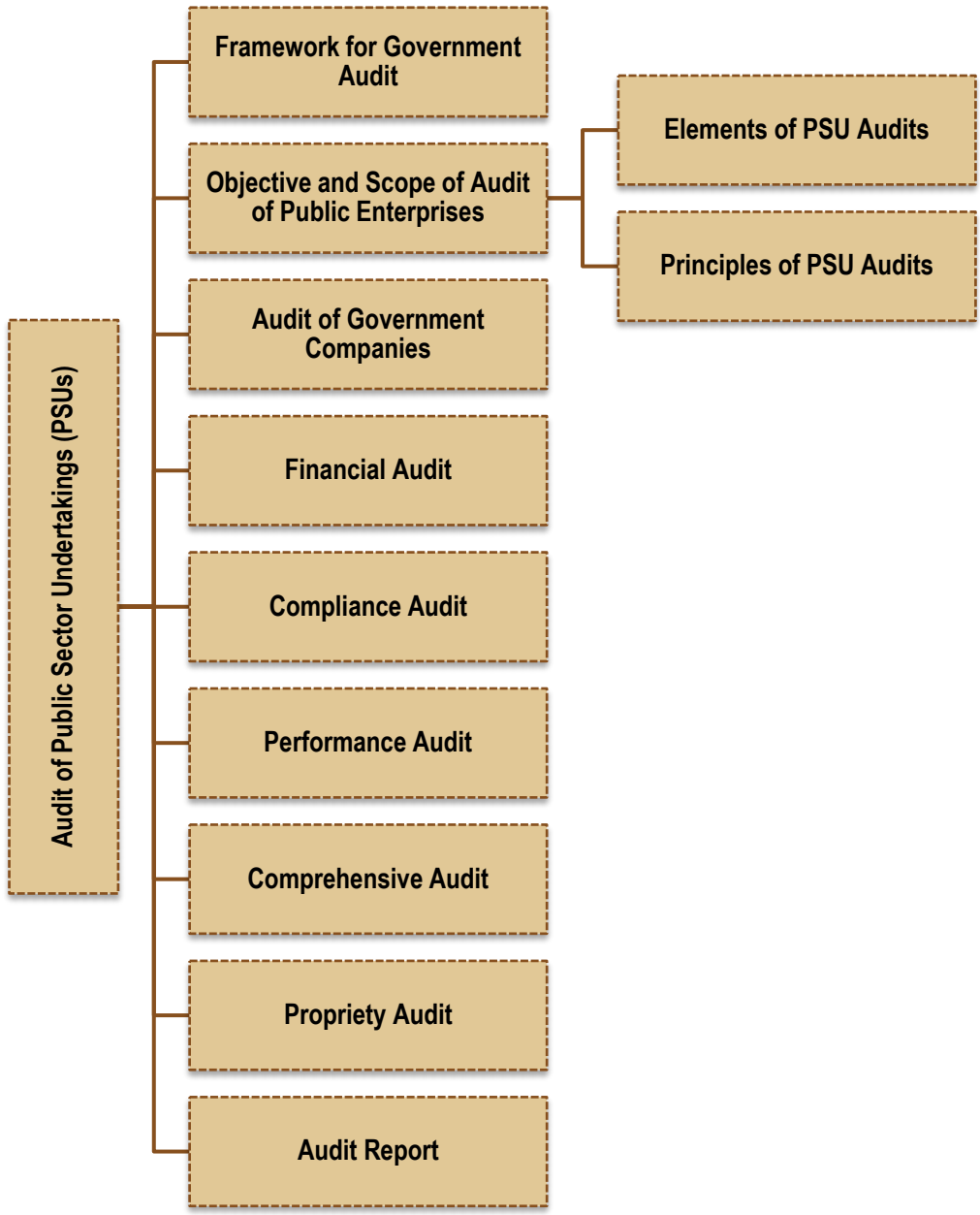
LEARNING OUTCOMES

After studying this chapter, you will be able to:

- Understand the framework for government audit.
- Understand objective and scope of public enterprises audit.
- Explain the elements of PSU Audits and Principles of PSU Audits.
- Understand & explain the concept of Compliance Audit, Performance Audit, Comprehensive Audit & Propriety Audit in relation to C&AG of India.
- Comprehend about Audit report of the C&AG of India.
- Apply & analyse the above-mentioned concepts in moderately complex scenarios.

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CHAPTER OVERVIEW



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CA Smita joined the Indian Audit and Accounts Service after qualifying as a Chartered Accountant and passing a competitive exam. Her initial appointment was in the Mumbai office. As part of the audit team conducting test audit of a PSU in insurance sector, she was verifying whether company was in compliance with regulatory norms for issuing insurance policies. This audit was in the nature of a compliance audit.

During the audit, she found that company had issued policies to certain companies dealing in sale of mobile handsets. These companies offered free insurance to the customers for their mobiles to cover fire, theft and similar risks. Such an offer was, however, subject to the buying of their software application by customers in the stipulated time. It was found by her that no actuarial valuation was conducted before issuing these policies and required approvals from competent authorities were not in place. As a result, she found losses on account of claim settlement due to non-compliant underwriting.

She was also part of team conducting performance audit of a government owned steel company. The said company had undertaken modernization and expansion of its steel plants and the performance audit of company was carried out. Her team highlighted many deficiencies in areas ranging from project planning, tender finalisation and project execution. In each area, specific deficiencies were pointed out. For instance, the team found that all material projects were delayed and not completed in time. It was also pointed that, although there was growth in domestic steel industry in the period covered by audit but the company failed to take advantage of favourable market conditions due to these delays.

After a few years, she was posted in a northern state after promotion. Her responsibility included compiling a report on the financial performance of government companies and statutory corporations owned by the State Government. This report also included impact of significant comments as a result of supplementary audit of the financial statements of government companies conducted by the C&AG.

One such comment related to supplementary audit already carried out by C&AG pertained to the improper determination of depreciation in the financial statements of a state-owned power generation company. Its impact was highlighted in the report pointing out that said improper determination has led to overstatement of profits by ₹ 20 crore.

Such is encompassing reach of C&AG in relation to PSUs!

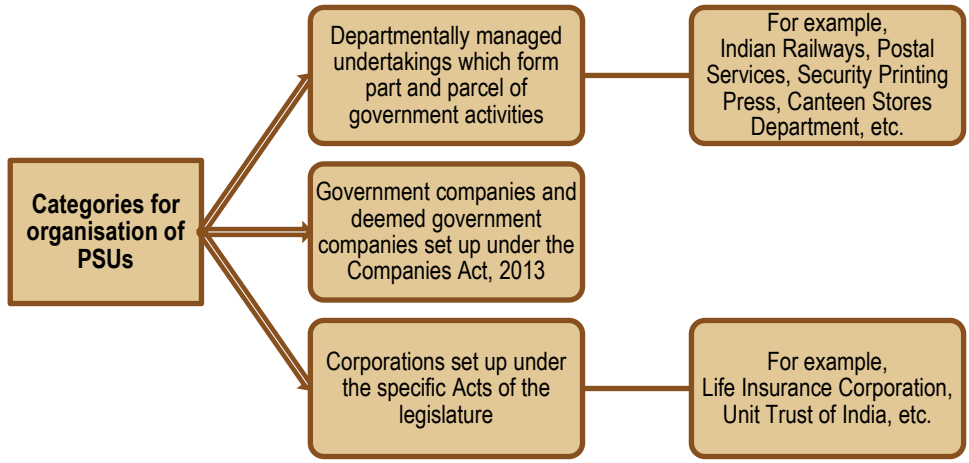
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1. INTRODUCTION

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*







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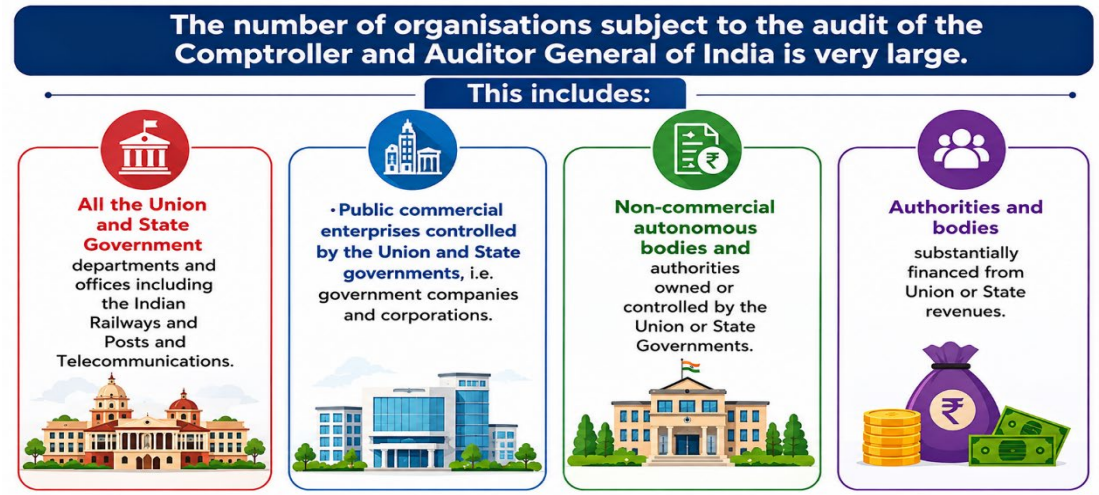
2. FRAMEWORK FOR GOVERNMENT AUDIT

In India, the Government audit is performed by an independent constitutional authority, i.e. **Comptroller and Auditor 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:

Article 148	• Appointment of C&AG by the President. • Special procedure for removal of C&AG, only on the ground of proven misbehaviour or incapacity. • Salary and other conditions of service to be determined by the Parliament.
Article 149	• Perform such duties and exercise such powers in relation to the accounts of the Union and States and of any other authority or body as may be prescribed by or under any law made by the Parliament. • The C&AG's (Duties, Powers and Conditions of Service) Act, 1971 defines these functions and powers in detail.
Article 150	• On the advice of the C&AG, President to prescribe such form in which accounts of the Union and States shall be kept.
Article 151	• Audit reports of the C&AG relating to the accounts of the Central/ State Government should be submitted to the President/Governor of the State who shall cause them to be laid before Parliament/State Legislative Assemblies.

The Comptroller and Auditor 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.



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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.

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.

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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 what economies, improvements in organization, efficiency or administrative reform, 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.

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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 to focus not only on the individual irregularity, but also 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;

(iii) 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;

(iv) 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.

TEST YOUR UNDERSTANDING 1

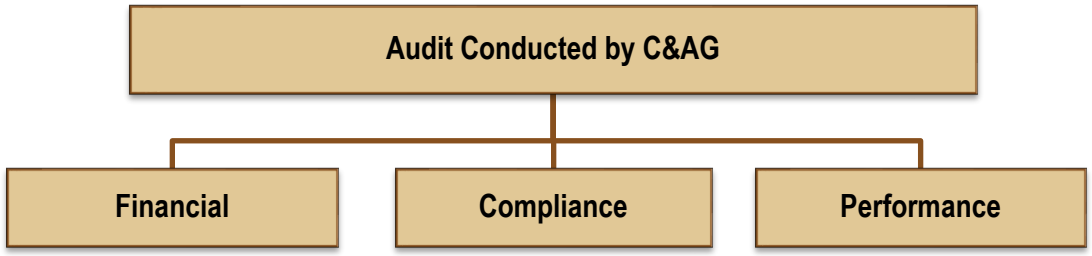
PGC & Associates are statutory auditors of BNPC Limited, a PSU in power sector. It is engaged in building large sized thermal power stations to accelerate development of power sector in the country. One of the financial committees of Parliament has decided to examine its physical and financial performance. It has also examined the audit findings of C&AG in respect of which action is yet to be taken by the said PSU. The committee also proposes to include in its report the performance of the company in various operational matters.

Which financial committee of Parliament deals with such matters? Outline its main functions.

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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

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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**).

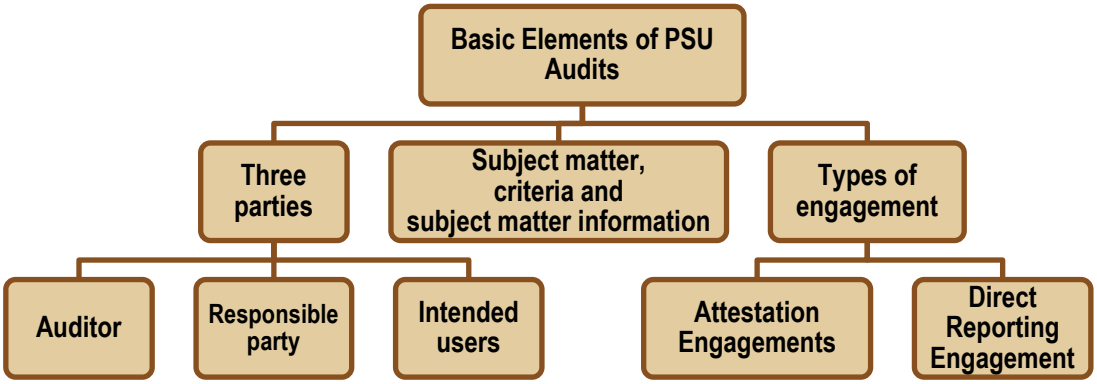
Efficiency- cum-performance audit, wherever used, is an objective examination of the financial and operational performance of an organisation, programme, authority or function and is oriented towards identifying opportunities for greater efficiency , economy, and effectiveness.

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.

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Audit of all public-sector undertakings have 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. The Comptroller and Auditor General of India (C&AG) and the Indian Audit and Accounts Department (IAAD) functioning under him, constitute the Supreme Audit Institution of India. Senior functionaries of the SAI representing the C&AG in the state are called Accountants General.

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.

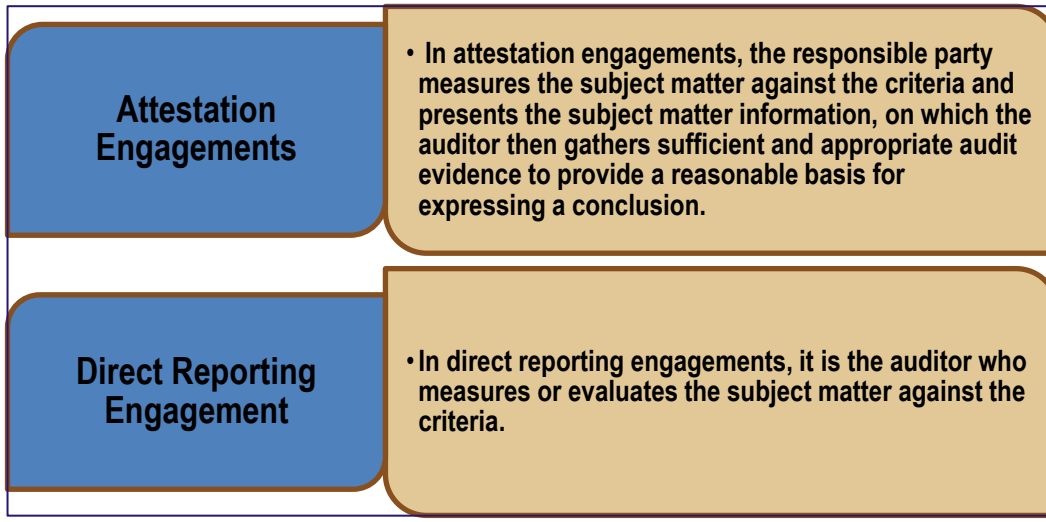
Intended Users: Intended users are the individuals, organizations or classes thereof for whom the auditor prepares the audit report.

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

Subject matter	• This refers to the information, condition or activity that is measured or evaluated against certain criteria.
Criteria	• These are the benchmarks used to evaluate the subject matter.
Subject matter information	• This refers to the outcome of evaluating or measuring the subject matter against the criteria.

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(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**.

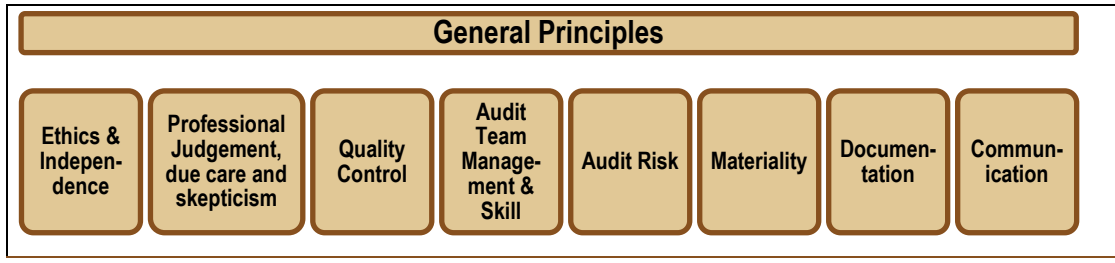
3.2 Principles of PSU Audits

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.

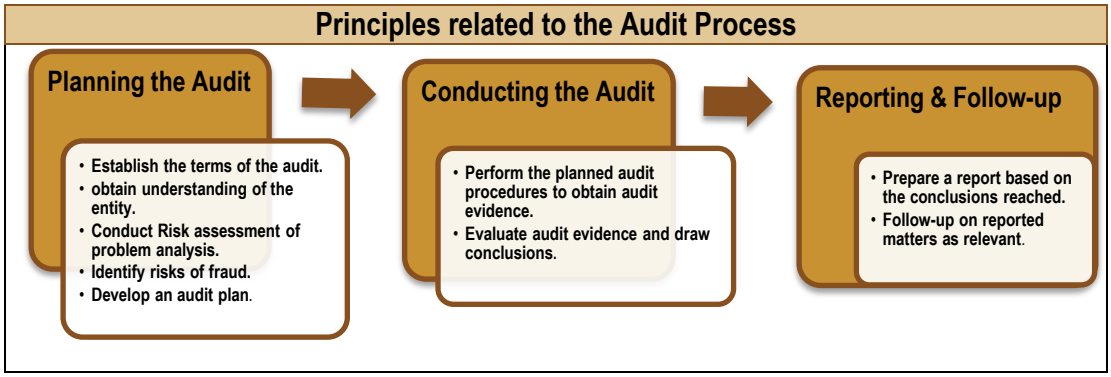
The principles are categorized into two distinct groups as below:

I. General Principles

II. Principles related to the Audit Process



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4. 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.

5. COMPLIANCE AUDIT

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

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



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Compliance auditing 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.

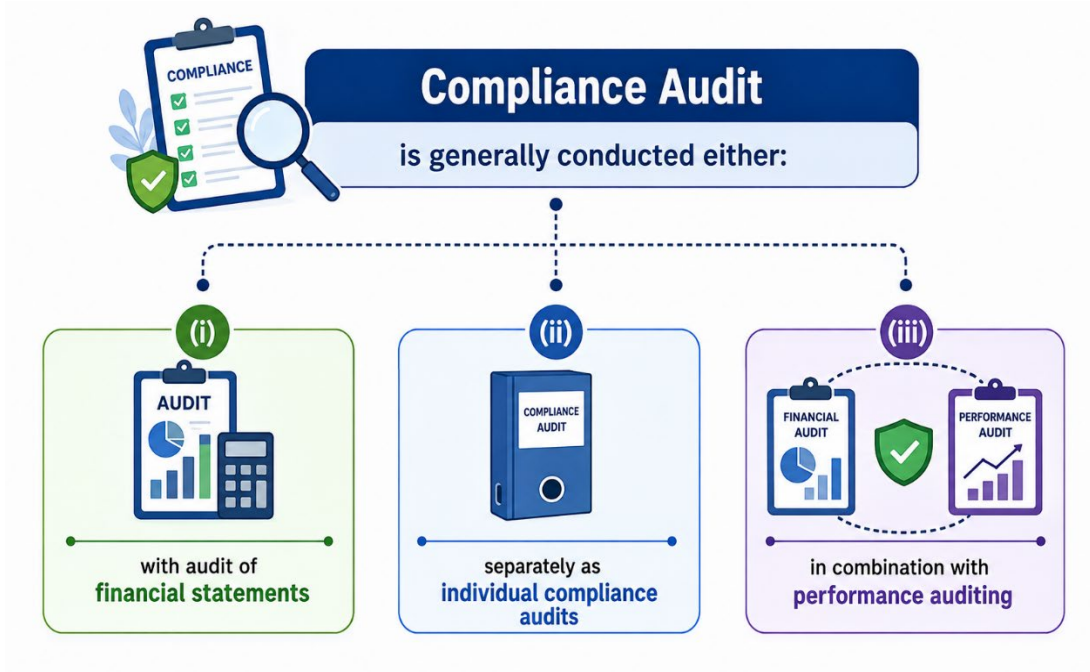
While regularity is emphasized in compliance auditing, propriety is equally pertinent in the public-sector context, in which there are certain expectations concerning financial management and the conduct of officials.

Perspective of Compliance Auditing: Compliance Auditing 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

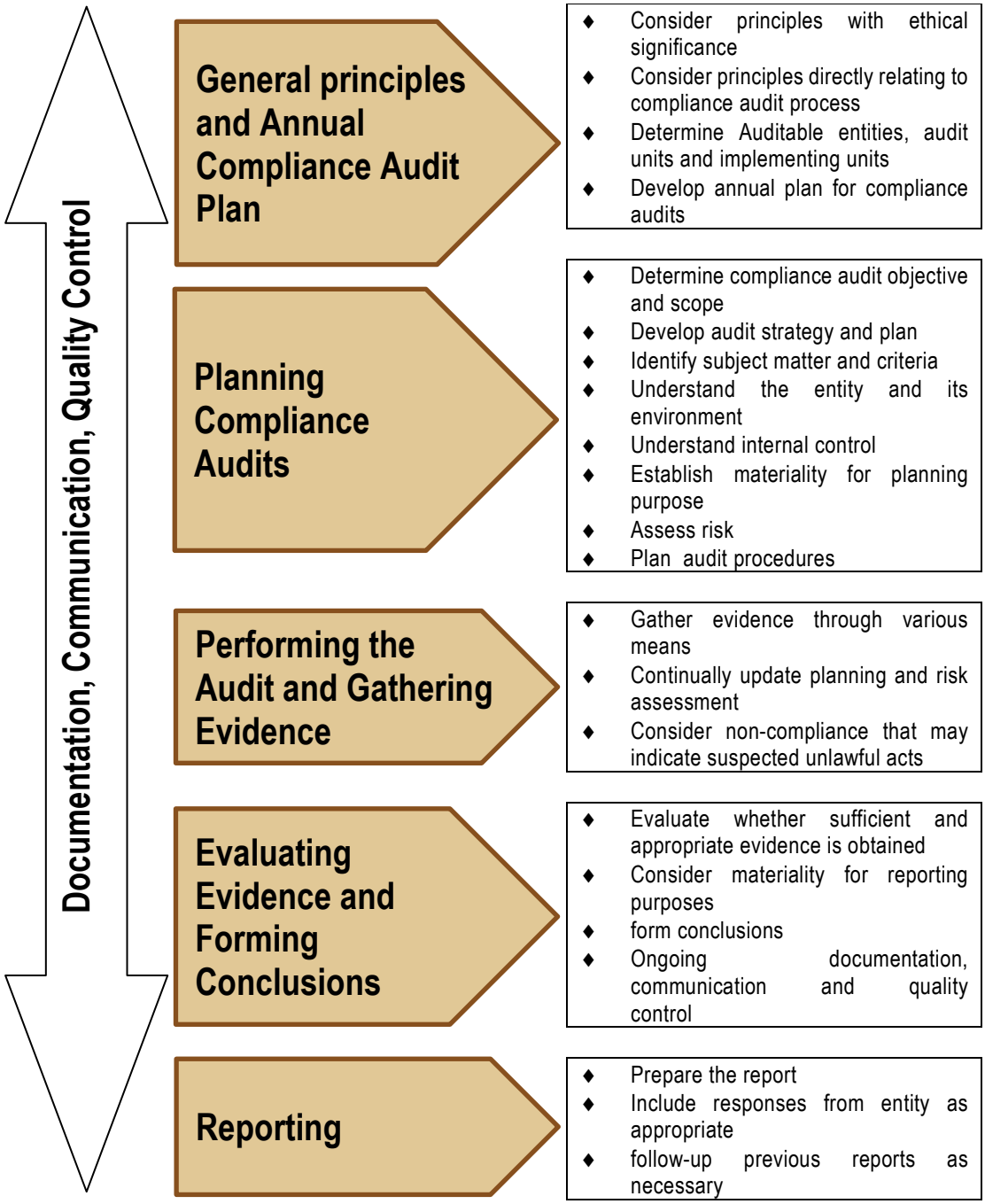
(iii) in combination with performance auditing.



When compliance auditing is part of a performance audit, compliance is seen as one of the aspects of economy, efficiency and effectiveness. Noncompliance may be the cause of, an explanation for, or a consequence of the state of the activities that are the subject matter of the performance audit.

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COMPLIANCE AUDIT PROCESS



(Source:- Compliance & Auditing Guidelines – C&AG of India)

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6. 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).

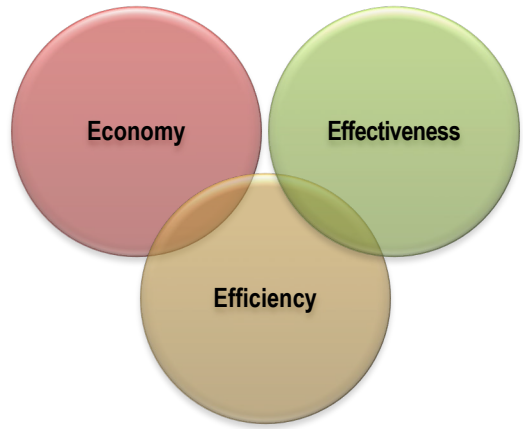
In conducting performance audit, the subordinate offices are guided by manual and auditing standards prescribed by C&AG.

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.

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When conducting audits of economy, the auditor may provide answers to such questions as: (ECA Performance Audit Manual, 2017)

- Have the best prices been obtained for consultancy services?
- Is there potential for reducing the cost of sickness absences?
- Are there procedures in place to ensure that transport costs of food aid are the lowest available?
- Has there been a waste of resources in achieving an output?

(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. When the audit objective of efficiency considers outputs, focus is usually on processes by which an organisation transforms inputs into outputs.

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.



In audits of efficiency, you might ask questions such as: How does the cost per job created by a training programme for the unemployed compare with similar costs per job elsewhere?

- Could project X have been implemented differently that would have resulted in improved timeliness and quality?
- Are adequate procedures and criteria for prioritising and selecting transport infrastructure projects to ensure maximum impact in place?

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- Are schools maximising the use of their information technology equipment?
- When the audit objective of efficiency considers outputs, you will usually focus on processes by which an organisation transforms inputs into outputs. **(Source : ECA Performance Audit Manual , 2017)**

(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 implementation of 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.



It focuses on questions such as:

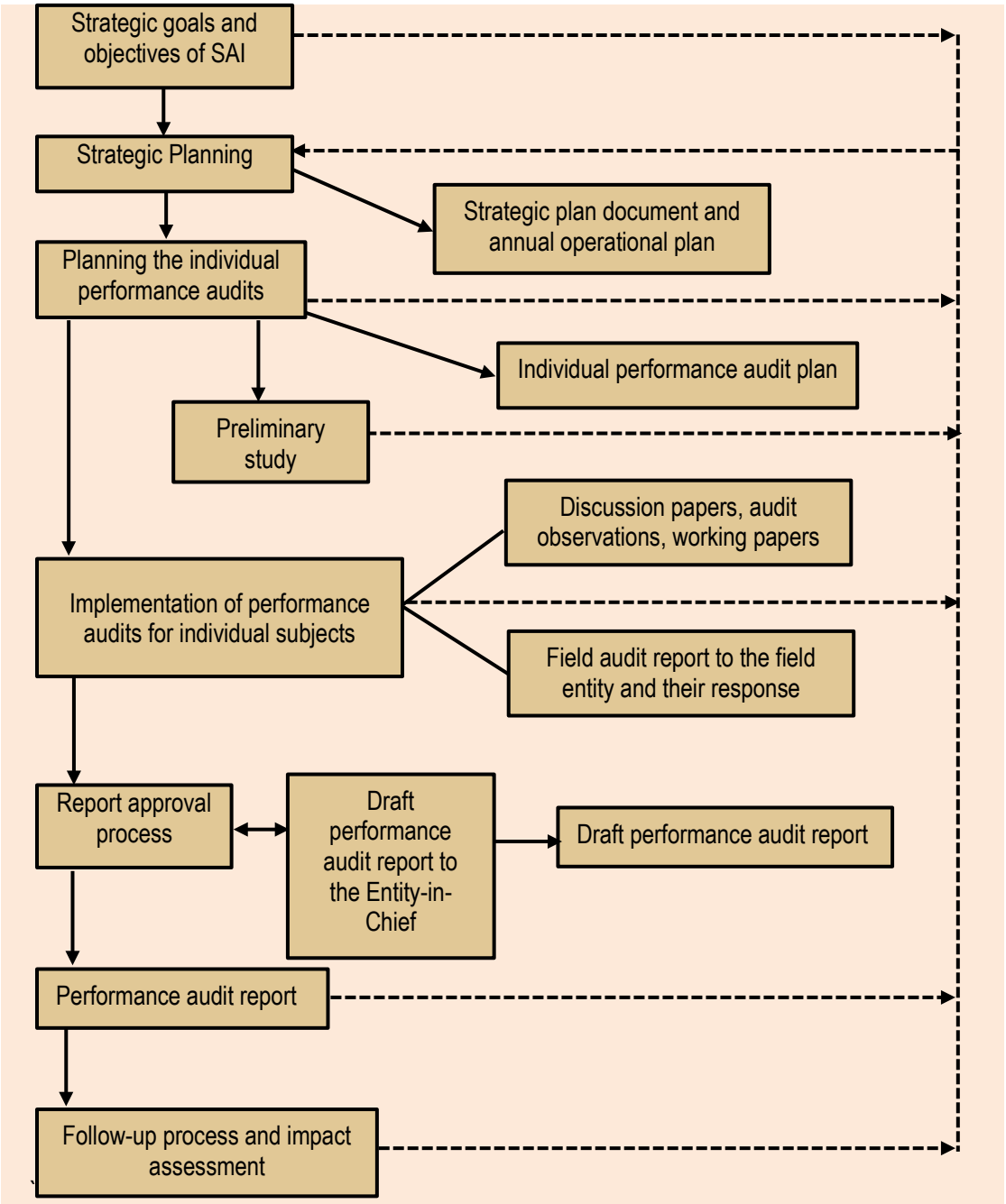
- *Have infrastructure projects contributed to increased traffic flow while improving safety and reducing journey times?*
- *Have suitable measures to monitor and mitigate the environmental impact in sector X been set up and properly implemented?*

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- *Are departments or entities achieving their objectives for all sectors of the community?*

(Source : ECA Performance Audit Manual,2017)

Performance Audit Cycle



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6.1 Objectives of Performance Audit

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.

Regulations on Audit and Accounts issued by C&AG lay down that the responsibility for the development of measurable objectives and performance indicators as also the systems of measurement rests with the Government departments or Heads of entities. They are also required to define intermediate and final outputs and outcomes in measurable and monitorable terms, standardise the unit cost of delivery and benchmark quality of outputs and outcomes.



1. 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.

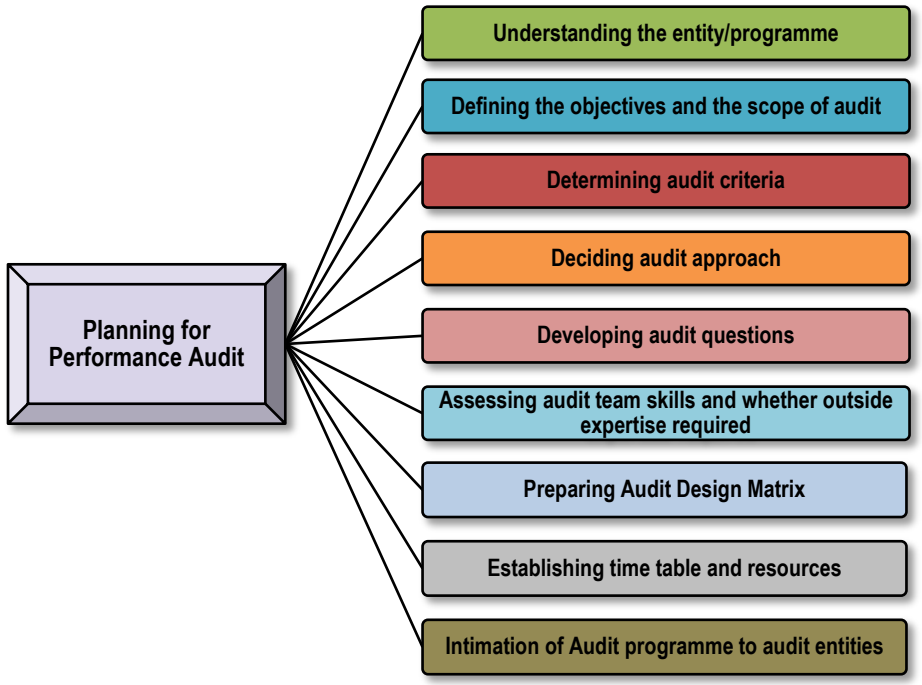
The auditor shall also have to point out lacuna, if any in the existing legal frame work or enforcement mechanism to strengthen the objective of legislation. Another possible area of critical audit may be to study actual level of compensation required in each area keeping in mind the local living conditions 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.

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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.

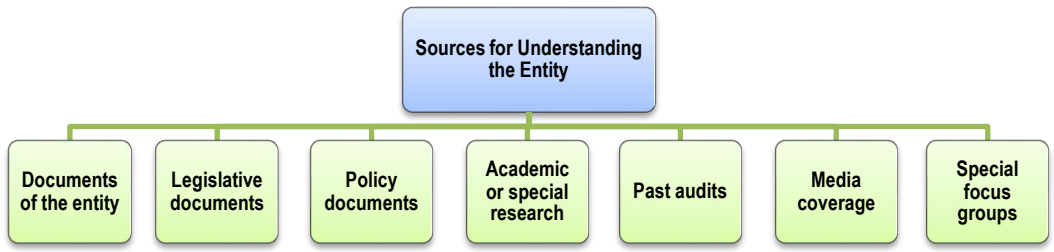
[**Note:** Interested students may refer to Background Material on Performance Audit of Public Sector Enterprises in India published by the CPE Committee of ICAI for further reference].

6.2 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.



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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 crisp & clear 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 on 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.

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(ii) policies, standards, directives and guidelines.

(iii) criteria used by the same entity or other entities in similar activities or programmes.

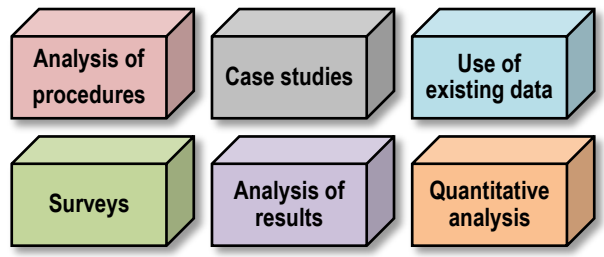
(iv) independent expert opinion and know how.

(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.

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

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(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.

Illustration

The objectives of audit in connection with a State Electricity Distribution Company were to ascertain whether the:

(i) **total cost of providing electricity is being recovered by timely submissions to the State Electricity Regulatory Commission;**

(ii) **tariff orders, sales circulars and sales instructions were issued timely, without any ambiguity. They were implemented in time;**

(iii) **metering, billing and collection was managed efficiently and effectively;**

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(iv) monitoring and internal controls were efficient.

What kind of audit is this? Prepare two sample observations which could be part of the audit report.

This is a performance audit. Sample observations could be:

(i) Non replacement of defective/ burnt meters: Large number of meters, much in excess of the permitted limit of 1% of the total meters were defective and their replacement was not completed within the stipulated time of 1 month. This resulted in billing on average basis for a continuous period of several months. This could result in losses as well as administrative hassles and disputes with consumers.

(ii) Under charging of meter rent: As per Schedule of Charges, the Company is required to charge meter rent of ₹30 per month for a single phase meter and ₹40 per month for three phase meter. It was observed that the Company had short charged meter rent of ₹60 lakh from 3 lakh consumers in 5 lakh bills during the period.

7. 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. The auditors combine aspects of Financial , Compliance and Performance audits. All the audit information is used in such a way that a holistic assessment is possible. 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.

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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 planned 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

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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.

TEST YOUR UNDERSTANDING 2

PS & Associates are statutory auditors of a Central Government owned company for a particular year. The statutory auditors were required to examine the following areas mandatorily, provide their specific replies and also their impact on financial statements for that particular year in their audit report.

1. Whether the company has system in place to process all the accounting transactions through IT system? If yes, the implications of processing accounting transactions outside IT system on the integrity of the accounts along with the financial implications, if any, may be stated.
2. Whether there is any restructuring of an existing loan or cases of waiver / write-off of debts / loans/ interest etc. made by a lender to the company due to the company's inability to repay the loan? If yes, the financial impact may be stated. Whether such cases are properly accounted for?
3. Whether funds (grants/subsidy etc.) received / receivable for specific schemes from Central Government or its agencies were properly accounted for / utilized as per its term and conditions? List the cases of deviation.

Can you determine the likely nature of such responsibility thrust upon auditors of above PSU?



8. 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. Propriety aspects in an audit already exists in the audits carried on by the C&AG.

8.1 Definition and Principles

Propriety audit stands for verification of transactions on the tests of public interest, commonly accepted customs and standards of conduct.

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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 in so far as the various formalities regarding rules and regulations are concerned but may still be highly wasteful.



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.

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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.

The functions of Auditor in the context of Propriety Audit may be specified as under as to :

- see that all expenditure incurred are properly planned.
- see that the size and channels of expenditure are rightful and expected to give maximum results.
- appraise whether those expenditure are likely to give optimum result.
- see that any substitute plan of action can bring about an improvement on current operation and as well as return from capital expenditure.
- examine the actions and decisions of the management to see that they are conductive to public interests and that they meet the standards of conduct.

Propriety Audit-Issues: 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.

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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.

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9. 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, and a general review of the working results of Government companies and corporations.

Key Takeaways

- 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. Such undertakings play a key role in the socio-economic development of the country.
- The accounts of selected government Companies along with the report of the statutory auditors are reviewed by C&AG by carrying out a supplementary audit.
- The scope and extent of audit carried out by C&AG in relation to PSUs may relate to compliance audit, financial audit and performance audit.
- Compliance audit is the independent assessment of whether a given subject matter is in compliance with the applicable criteria.
- Performance audit is an objective and systematic examination of evidence for providing an independent assessment of the performance of a government organization, program, activity

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or function in order to provide information to improve public accountability and facilitate decision making by parties with responsibilities to oversee or initiate corrective action.

- Performance audits usually address the issues of economy, efficiency and effectiveness.
- Comprehensive audit combines aspects of financial, compliance and performance audits. All the audit information is used in such a way that a holistic assessment is possible.
- 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, however, it may still be highly wasteful.

For a concise revision of the key concepts covered in this chapter, students may refer to the **Saransh Booklet for Paper 3: Advanced Auditing, Assurance and Professional Ethics**, which serves as a useful last-mile revision resource for examination preparation. Saransh Booklet can be accessed at **https://boslive.icai.org/AAAPE_SARANSH.pdf**

TEST YOUR KNOWLEDGE

Theoretical Questions

1. *The reports of the Comptroller and Auditor General of India on the audit of PSUs are presented to the Parliament and to various state legislatures to facilitate a proper consideration. Enumerate the contents of Audit Report presented by C & AG.*
2. *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?*
3. *Sunlight Limited is a public sector undertaking engaged in production of electricity from solar power. It had commissioned a new project near Goa with a new technology for a cost of ₹ 5,750 crore. The project had seen delay in commencement and cost overrun. State the matters that a Comprehensive Audit by C&AG may cover in reporting on the performance and efficiency of this project.*
4. *"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,*

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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." Briefly discuss the issues addressed by Performance Audits conducted in accordance with the guidelines issued by C&AG.

5. *BT Ltd., a company wholly owned by the Central Government was disinvested during the previous year, resulting in 40% of the shares being held by public. The shares were also listed on the BSE. Since the shares were listed, all the listing requirements were applicable, including publication of quarterly results, submission of information to the BSE etc.*

   Sam, the FM of the company is of the opinion that now the company is subject to stringent control by BSE and the markets, therefore the auditing requirements of a limited company in private sector under the Companies Act 2013 would be applicable to the company and the C&AG will not have any role to play. Comment.

6. *You have been appointed as auditor of a AKY Ltd. After having determined the audit objectives, now you have been requested to draft audit criteria. What are the sources that you will use while doing the task?*

7. *Comptroller & Auditor General appointed Verma & Associates, a chartered accountant firm, to conduct Performance audit of MAP Ltd., a public sector undertaking of Government of India. The firm conducted the audit with a view to check all the expenses of the unit are in conformity with the public interest and publicly accepted customs. The audit report submitted by audit firm was rejected by C&AG. Give your opinion on the action of C&AG.*

8. *The objectives of audit in connection with a State Electricity Distribution Company were to ascertain whether the:*

   (i) total cost of providing electricity is being recovered by timely submissions to the State Electricity Regulatory Commission;

   (ii) tariff orders, sales circulars and sales instructions were issued timely, without any ambiguity. They were implemented in time;

   (iii) metering, billing and collection was managed efficiently and effectively;

   (iv) monitoring and internal controls were efficient.

   What kind of audit is referred in the above scenario? Also briefly discuss the steps suggested to the auditors for planning such an audit.

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9. *During the course of an audit of a state government department, the Office of the Comptroller & Auditor General of India (CAG) observed that the prescribed law in the state defined a "flat" based on the following two criteria in a premises:*

   - *Dwelling units exceeding a threshold limit*
   - *Buildings with a total area surpassing a threshold limit*

   However, it was noted during the audit that the relevant database did not include a column for entering the area of the building. Consequently, a certain number of buildings were identified as flats even though they had fewer dwelling units than the threshold limit. In the absence of data regarding the area, the audit team directed physical verification of these flats. The physical verification confirmed that these buildings were incorrectly classified as flats, resulting in the department undercollecting water charges.

   Identify type and nature of audit being performed by Office of Comptroller & Auditor General of India. To whom report of such audit was likely to have been submitted.

10. *Direct Benefit Transfer (DBT) is a major reform initiative of the Government of India to ensure better and timely delivery of benefits from Government to people. It marks a paradigm shift in the process of delivering benefits like wage payments, fuel subsidies, food grain subsidies, etc. directly into the bank accounts of the beneficiaries removing leakages and enhancing financial inclusion.*

    The office of C & AG of India is likely to undertake a performance audit for a block of years in a state of some selected social security pension schemes and scholarship schemes under DBT. What are likely to be objectives of such performance audit? Explain the meaning of "audit criteria" and also discuss how these can be determined in above case.

11. A state government owned PSU was involved in setting up of a thermal power plant in the state. The C & AG, in its audit report, pointed out delay in completion of work due to failure to decide on the type of water treatment in the cooling plant on a timely basis. Besides, other reasons leading to delay like frequent changes in lay-out and re-testing of soil by the company were pointed out. What kind of audit is referred in the above case? Describe the methods which could be used in conducting such audits.

12 RST Ltd., a public sector company engaged in power generation, has recently completed five years of operations. The Board of Directors has requested an audit to evaluate not only the accuracy of its financial statements but also the efficiency of operations, adequacy of internal controls, and overall performance of the company. Preliminary review shows:

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- *Several projects experienced cost overruns compared to approved budgets.*
- *Some plants are operating below installed capacity.*
- *Raw material and fuel consumption exceed standard norms, and inventory management appears weak.*

Identify the type of audit suitable in this scenario and suggest the key issues that the auditors should examine during such type of audit, considering the company's operational and financial activities.

13. *The Government of India launched a rural development scheme to undertake projects aimed at improving infrastructure, healthcare and education in the rural areas. To execute the projects the Central Government provided funds to the state government. The Comptroller and Auditor General of India wants to ensure that the funds provided to the State Governments have been utilized for the identified purposes and that public interest has not been harmed. You are appointed by C & AG to conduct the propriety audit and report on the funds utilized by the state government for building hospitals, school buildings and roads and submit a report on the wastefulness in public administration and cases of improper, avoidable and infructuous expenditures, if any, has been done. What functions as an auditor will be performed by you?*

14. *LNG Corporation is a government-owned entity, is engaged in operating liquefied natural Gas. The organization recently underwent a compliance audit conducted by the Comptroller and Auditor General (C&AG) of India. The audit aimed to assess whether the PSU's financial transactions, procurement activities and operations complied with relevant laws, regulations and internal guidelines.*

In context of the above, you are required to:

(i) Explain the concept of compliance audit and its perspective.

(ii) What shall be the concern of the auditor when undertaking compliance audit?

15. *The Comptroller and Auditor General of India (C&AG) appointed M/s. VR & Associates, a firm of Chartered Accountants, to conduct the audit of Sunshine Ltd., a Public Sector Undertaking (PSU) under the Government of India and intimated to the auditors about the following concerns in respect of the PSU.*

Sunshine Ltd. proposed to set up a solar panel manufacturing project in North Gujarat with an estimated cost of ₹5,750 crores, which included ₹2,000 crores earmarked for Research and Development (R&D). While all approvals, documentation, and statutory

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requirements were duly complied with, the C&AG expressed concern that the proposed R&D expenditure appeared wasteful and lacking justification on the tests of public interest, as several established companies were already engaged in similar activities in that region.

Identify the type of audit that the C&AG expects M/s. VR & Associates to conduct in this context. Also, explain the principles of this audit.

16. ***The Ministry of Information Technology of the Government of India has initiated a large-scale infrastructure project to improve rural connectivity under its "Digital Connect" programme. As part of the audit team, you are assigned to conduct a performance audit of this project with a focus on assessing its efficiency. While auditing the efficiency of the project, what key aspects should the auditor consider to determine whether resources are used efficiently.***

Answers to Test Your Understanding

1. The said matters are dealt by Committee on Public Undertakings (COPU). 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.

2. The given areas for which statutory auditors of PSU were required to examine, report and indicate impact of these matters in financial statements are likely to relate to directions issued by C&AG to statutory auditors under section 143(5) of the Companies Act, 2013.

In terms of section 143(5), in case of a government company, the C&AG has the power to direct the auditor the manners in which accounts of company are required to be audited and auditor shall submit audit report which among other things, include the directions, if any, issued by the C&AG the action taken thereon and its impact on the accounts and financial statements of the company.

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Hints /Answers to Theoretical Questions

1. Refer Para 9.

2. Factors to be considered while planning the Performance Audit: Refer Para 6.2.

3. Refer Para 7.

4. Refer Para 6.

5. Section 2(45) of the Companies Act, 2013, defines a "Government Company" as 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 or more State Governments, and includes a company which is a subsidiary company of such a Government company. The auditors of these government 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. The listing of company's shares on a stock exchange is irrelevant for this purpose and hence Sam's opinion is not correct.

6. Refer Para 6.2.

7. In the given scenario, C&AG appointed Verma & Associates, a chartered accountant firm, to conduct Performance Audit of MAP Ltd., a PSU of Government of India. The firm conducted audit with a view to check all the expenses of the unit are in conformity to the public interest and publicly accepted customs, which is not 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.

Therefore, 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

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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.

Regulations on Audit and Accounts issued by C&AG lay down that the responsibility for the development of measurable objectives and performance indicators as also the systems of measurement rests with the Government departments or Heads of entities. They are also required to define intermediate and final outputs and outcomes in measurable and monitorable terms, standardise the unit cost of delivery and benchmark quality of outputs and outcomes.

Thus, rejection of audit report (submitted by audit firm) by C&AG is in order as audit with a view to mere check all the expenses of the unit are in conformity to the public interest and publicly accepted customs done by audit firm is not performance audit in all aspects.

8. In the given scenario, in view of the objectives discussed, performance audit is being referred. Refer Para 6.2.

9. In the given case, it is a "Compliance Audit" performed by Office of Comptroller & Auditor General of India.

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

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

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Under Article 151, audit reports of the C&AG relating to the accounts of the Central/ State Government should be submitted to the President/Governor of the State who shall cause them to be laid before Parliament/State Legislative Assemblies.

In the given situation, the report relates to the State Department. Therefore, report was likely to have been submitted to Governor of state to be laid before State legislative assembly.

10. The likely objectives of performance audit to be conducted by office of C & AG of India of some selected social security pension schemes and scholarship schemes in a state could be: -

- Whether proper planning and process were in place to capture data of beneficiaries under above schemes
- Whether necessary steps were taken for implementation of DBT like preventing delay in payments to the intended beneficiaries and pilferage and duplication
- Whether the infrastructure, organization and management of DBT were adequate and effective.

"Audit criteria" are standards used to determine whether a programme 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.

In the above situation, various documents issued by Government of India and state government like circulars, instructions, Standard operating procedure manuals, guidelines of schemes on identification and authentication of beneficiaries etc., general management and subject matter literature can be used to determine "audit criteria".

11. In the given situation, Performance Audit will be conducted as it 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.

Refer Point D Under para 6.2 for the methods which could be used in conducting performance audits.

12. The audit required in this scenario is a Comprehensive Audit (Efficiency-Cum-Performance Audit). The areas covered in comprehensive audit naturally vary from enterprise to enterprise depending on the nature of the enterprise, its objectives and operations. The auditors combine aspects of Financial, Compliance and Performance

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audits. All the audit information is used in such a way that a holistic assessment is possible. Refer Para 7 for key issues examined in comprehensive audit.

13. *Refer Function of Auditor in case of Propriety Audit under Para 8.1.*

14. *Refer Para 5.*

15. *The type of audit that the Comptroller and Auditor General of India (C&AG) expect M/s. VR & Associates to conduct in this context is Propriety Audit since C&AG expressed concern that the proposed R&D expenditure of `2,000 crores appeared wasteful and lacking justification on the test of public interest. Propriety audit stands for verification of transactions on the tests of public interest, commonly accepted customs and standards of conduct.*

    Propriety requires transactions, and more particularly expenditure, to conform to certain general principles. The following principles should be applied by M/s. VR & Associates:

    (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.

16. *Refer point (ii) Efficiency under Para 6.*

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