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## Commercial Audit

The audit of Government Companies and Corporations, which were set up mostly after Independence, had raised a number of issues concerning the audit jurisdiction of the C&AG for these entities. Initially, when State owned companies were set up, C&AG's audit was provided in their Articles of Association. When the Government embarked on a massive industrialization drive by setting up Government owned enterprises in varied areas, in fulfillment of its role envisaged in Industrial Policy Resolution, 1948, it took recourse to two forms—a large number of state enterprises were set up as Private Limited Companies or as Statutory Corporations. The setting up of a number of companies in early fifties as Private Limited Company without any specific status was considered contrary to the Constitution by the first C&AG, V. Narahari Rao (1948–1954). In his famous deposition before the Public Accounts Committee in December 1952, Narhari Rao expressed the opinion that the 'Formation of Private Companies under the Indian Companies Act for the management of Government industrial undertakings from the Consolidated Fund was a fraud on the Companies Act and also on the Constitution, because money could not be taken away from the Consolidated Fund for the establishment and transformation of certain concerns into Private Companies in the name of the President and Secretary to the Government. Conversion of a Government concern into a Private Company solely by executive action was unconstitutional.'<sup>1</sup> After an acrimonious debate and fight with the Ministry of Finance but backed by the support of the Public Accounts Committee, the audit by C&AG of these Companies was provided when, in December 1953 Finance Minister informed the House (Lok Sabha)

about Government's intention to bring before Parliament proposals for legislation which would cover Industrial Undertakings of Government and also to provide for audit of C&AG compulsory for them and presentation of his reports to Parliament in usual manner for scrutiny by the PAC. Eventually, when the Indian Companies Act, 1956 was promulgated, it contained provisions for the audit of Government Companies by the C&AG under Section 619. The provision for audit of deemed Government Companies was brought under a new Section 619 (B) by an amendment in 1974 on the suggestion of PAC.

Having secured the audit of Government Companies and Statutory Corporations, the biggest challenge was to create a team of professional auditors to carry out the duties of auditing them. R.K. Chandrasekharan<sup>2</sup> in his book has detailed the manner in which the commercial audit was built, brick by brick first by V. Narahari Rao (1948–1954) and later by A.K. Chanda (1954–1960) and subsequently during the tenure of A.K. Roy (1960–1966), Audit Report (Commercial) started coming out. A major expansion of the Commercial Audit Wing was done during the tenure of S. Ranganathan (1966–1972) when, on the basis of Administrative Reforms Commission's (ARC) recommendations, several new commercial audit offices were set up. These were called offices of Member, Audit Board and Director of Commercial Audit. The Audit Board mechanism was also introduced on the basis of ARC Report. An Audit Board was constituted only when a comprehensive appraisal of any PSU was undertaken to guide and supervise that appraisal. It consisted of 5 persons including the Chairman viz. Dy. Comptroller and Auditor General (Comml.)<sup>3</sup> who was common to all such Boards. Of the members, one was the concerned Director of Commercial Audit who was the Principal Audit Officer of the PSU concerned and one more Director of Commercial Audit was co-opted; besides, there were two technical experts nominated as members of the Audit Board by the Ministry/Department relevant to the PSU concerned. The Audit Board mechanism, however, has undergone a comprehensive and qualitative change recently as discussed elsewhere in this Chapter. In effect, 9 new offices were created between 1970 and 1978. During the tenure of A. Baksi (1972–1978), 7 new offices of MAB and Director, Commercial Audit<sup>4</sup> were created. As on March 1991, there were 12 offices of Pr. Directors, Commercial Audit with 14 branch offices. In March 2005, there were 12 Pr. Director offices, 15 branch offices and 120 Resident Audit Offices (RAOs). RAOs are meant

for specific Companies/ Corporations. These offices were engaged in the audit of 288 Central Government Companies, 89 deemed Government Companies and 6 Statutory Corporations. 5 General Insurance Companies were also in the audit jurisdiction of C&AG. The State Government undertakings, numbering about 1233 as on 31 March 2005<sup>5</sup>, are audited by the concerned State Accountants General. The total staff strength in Commercial Audit in October 1990 was 2218 while in March 2005, it was 2094. The Commercial Audit Wing of C&AG is headed by DAI (Comml.)-cum-Chairman, Audit Board and is responsible for the audit of Central Government PSUs. He is, however, cadre controlling authority for commercial cadre of Central audit offices and State audit offices (Accountant General offices). The audit of State PSUs conducted by State Accountants General is overseen at Headquarters by an Addl. DAI. The appointment of statutory auditors, however, is processed in the DAI (Comml.) Wing for all the PSUs—Central as well as State.

Central Public Sector Undertakings (PSUs) in 2006 (31 March) numbered 404—consisting of Statutory Corporations (6), Government Companies (304) and Deemed Government Companies (94); the Government investment in Equity Capital in 277 PSUs (including six Central Statutory Corporations) for which data was available, was Rs. 1,21,006 crore<sup>6</sup>. As regards Return on Investment (ROI) or profitability, net profit of 175 Central Government Companies and Corporations was Rs. 79,427 crore. 69 per cent of this profit was contributed by 38 PSUs—these were mostly in Telecom, Petroleum, Power and Coal & Lignite Sectors. 94 PSUs suffered losses. Dividend paid to Government of India represented 14.33 per cent of total investment of Government in PSUs including Corporations.

#### CHANGES IN THE COMPANIES ACT

There have been, some changes in the Companies Act that are relevant to C&AG's audit of Government Companies. The one significant amendment made in the year 2000 to the Act related to the appointment of statutory auditors of Government Companies (Chartered Accountants) directly by the C&AG; earlier they were appointed by the Department of Company Affairs on the recommendations of C&AG. Notably, even when C&AG was recommending authority for the appointment of statutory auditors (Chartered Accountants), his advice was, by convention, always accepted.

Another important change was the insertion of a new section 210A in the Companies Act, vide amendment to Act in 1999, empowering Central Government to constitute National Advisory Committee on Accounting Standards (Committee) to advise the Central Government on formulation and laying down of Accounting Standards for adoption by companies. Section 210 A(2)(e) provides that this Committee shall have one representative of C&AG of India, amongst others. The Central Government have constituted the Committee accordingly, in which Director General (Comml.) is presently representing the Audit Department.

The Chartered Accountants Act 1949, was amended in 2006 to establish Quality Review Board (QRB) which shall have a Chairperson and ten other members, five members of the Board shall be nominated by the Central Council of Institute of Chartered Accountants of India (ICAI) while the other five members shall be nominated by the Central Government. A representative of Comptroller and Auditor General of India was also nominated on the QRB of the ICAI. The C&AG in May 2007, nominated Director General (Commercial)<sup>7</sup> as his nominee on the QRB. The Board, inter-alia, will make recommendations to the Council with regard to quality of services provided by the members of the Institute, including audit services after a review of these services. It will also guide the members of the Institute to improve the quality of services and adhere to various statutory and other regulatory requirements.

During the last 5 years or so, some Committees were appointed for specific purposes including reviewing the Companies Act and make their recommendations. Irani Committee figures as most prominent amongst these; another Committee popularly known as Arjun Sengupta Committee was constituted to consider autonomy, delegation of financial powers etc. to Central PSUs. Their report and recommendations were a subject of intense debate and discussion in C&AG's Organization. These are discussed elsewhere in this Chapter.

#### C&AG'S POWERS REGARDING AUDIT OF COMMERCIAL BODIES

C&AG's audit deals with three types of commercial undertakings:

- ❖ Departmentally run commercial undertakings
- ❖ Statutory Corporations

❖ Government Companies including Deemed Government Companies<sup>8</sup>

The powers to audit Departmental Commercial undertakings is derived from the C&AG's DPC (Act) since this audit is as an audit of expenditure from Consolidated Fund of India or State as the case may be. The audit of these undertakings is conducted in State by Commercial Wing of the Accountants General or by Accountants General (Commercial) wherever separate Commercial Accountants General are posted. In Central audit offices, this audit is entrusted to Civil Wing both in Central and State Reports. However, the results of audit of departmental entities are reported in C&AG's Report Civil.

Statutory Corporations are audited by the C&AG in terms of the provisions of the relevant Act constituting that Corporation. The audit of these Corporations includes certification of Annual Accounts and is conducted by the Commercial Audit branch of C&AG. Central Statutory Corporations now number just six.

The third category of Commercial entities which is the largest is that of Government Companies set up under the Companies Act, 1956. C&AG derives his authority for audit of Government Companies from the relevant provisions of Companies Act, 1956 read with Section 19 of C&AG's (DPC) Act. Very briefly, these relate to:

- ❖ Appointment of Auditors of Government Companies and deemed Government Companies [(Section 619 (2)].
- ❖ Issue of directions to the Statutory Auditors regarding the manner in which Companies shall be audited [Section 619 (3) (a)].
- ❖ Conducting a Supplementary audit or test audit of the accounts of the Government Companies [Section 619 (3) (b)].
- ❖ Comment upon or supplement, Audit Report of Statutory auditor in such a manner as he may think fit [Section 619 (4)].

Section 619 B extends the provisions of section 619 to deemed Government Companies.

The Reports of the C&AG in relation to accounts of a Government Company /Corporation shall be submitted to Government or Governments concerned who shall cause it to be laid before the Legislature under the powers vested vide Section 19 (1) of the C&AG's (DPC) Act, 1971, read with the provisions of Sections 617 to 619 of the Companies Act, 1956.

### APPOINTMENT OF AUDITORS OF GOVERNMENT COMPANIES ETC.

With the change in the Companies Act in 2000, C&AG is now the appointing authority for statutory auditor of Government Companies under section 617 and deemed Government Companies under section 619 B. He maintains a panel for the purpose, where the interested firms of Chartered Accountants are empanelled on the basis of their applications. Empanelment criteria is very transparent and is in public domain through Press Advertisement etc. Beginning from 1993 when N. Sivasubramanian was the DAI (Commercial) and Chairman, Audit Board, a computerized data base of the various applicants for the registration in the panel was introduced, gradually more refinements towards transparency in the registration and objectivity in the selection of firms for audit assignment has taken place. A couple of years back C&AG's office developed a system of 'online submission'<sup>9</sup> of forms by CA firms for registration. This has not only facilitated considerably in reducing the time and energy in data entry work in the preparation of panel for PSU auditors, but has also ensured that there is no error in the data as the same is entered by the firms themselves. The final panel prepared on the basis of ranking obtained through the criteria of points earned by each firm is cross-checked by an independent committee headed by a Joint Secretary level officer (who does not belong to the Commercial Audit Branch). The CA firms which are listed in the C&AG's panel are also picked up often by other organizations by making a request to the C&AG to release the names from his panel. Such is the credibility of the system.

Prior to 2003, partnership firms with two full time partners (one of them FCA) were considered for empanelment except for special regions like J&K and North Eastern States. From 2003-04, as per directions of Honourable Supreme Court of India, all firms having at least one full time FCA are eligible for empanelment.

The Reserve Bank of India appoints statutory auditors (firm of Chartered Accountants) for the audit of Public Sector Banks and Financial Institutions for which purpose, C&AG provides RBI a panel of auditors from which the Bank selects<sup>10</sup> the statutory central auditors for the audit of annual accounts of Public Sector Banks etc.

As a result of these reforms, C&AG is able to appoint the statutory auditors by August, which is very much timely—this is

as good as in the case of Private Companies (Public Limited Companies).

#### DIRECTIONS UNDER SECTION 619 (3)

The Companies Act empowers C&AG to give directions to the Auditors under Section 619 (3) regarding the manner in which they will conduct the audit with reference to certain specified areas which C&AG spells out. It is important to clarify that these directions, in no way, infringe upon the independent audit of the company in accordance with the ICAI Accounting Standards, their professional guidelines and other instructions. The objective of directions under section 619(3)(a) of the Companies Act, has been spelt out by C&AG thus:

'The directions issued by C&AG under section 619(3)(a) are primarily aimed at ensuring compliance with Accounting Standards and evaluating internal controls relating to financial reporting in the auditee organization.'<sup>11</sup>

The subjects on which C&AG gives directions to the Chartered Accountants (statutory auditors) under 619 (3) (a) are those which relate to systems and procedures, financial controls, costing system, fraud/ risks, etc. and, of late, Corporate Governance issues. These subjects are not covered in the normal audit of Annual Accounts by Auditor in the case of Government Companies. This right is made available to them only by virtue of C&AG's powers as the final auditor of the PSUs. There have been allegations, at times, by well informed persons (for example, JJ Irani Committee) that directions under Section 619(3) is an infringement on the independence of the CA to conduct the audit as per ICAI standards and guidelines, which, as would be clear from the foregoing is not correct.

C&AG issued in September 2004, revised directions to the statutory auditors under this section after issue of revised Companies (Auditors Report) Order, 2003 by Government of India. These are fairly adequate and cover most of the important areas/ aspects of Companies working; these specially focus on important and topical issues like corporate governance, business fraud and risk, environmental issues, etc.

#### SUPPLEMENTARY AUDIT BY C&AG

C&AG has been empowered under Section 619 (4) to review the Audit Report of the Statutory Auditor and comment upon or

supplement his Audit Report in such a manner as he may think fit. Under Section 619(3) (b) of Companies Act, C&AG can also carry out supplementary audit or test audit of the accounts of the Government Company. The power to carry out supplementary audit and comment upon the audit of the Statutory Auditors has been a subject of debate amongst various stakeholders of Corporate World. Standing Conference of Public Enterprises (SCOPE), which is a lobby group consisting of Chief Executive Officers of PSUs, has from time to time questioned not only this power but they desired that C&AG should whither away entirely from this function. JJ Irani Committee in their report have also not favoured this power with the C&AG. As would be seen elsewhere in this Chapter, Arjun Sengupta Committee is also not favourably inclined towards this. These persons have held the view that C&AG's Supplementary Audit of Accounts of the Government Companies is frivolous or duplication of efforts and not worth the trouble. This argument loses its shine and rationality when the results of C&AG's Supplementary Audit are seen. The C&AG does not undertake Supplementary Audit under Section 619 B of all the Government companies. There is a criteria for such a selection. Recently (in July 2006) the criteria for selection of Government Companies for audit under Section 619 (4) of Companies Act has been revised and the threshold of paid up capital/turnover of the company for this purpose has been enhanced. This will result in a much larger number of Government Companies' Accounts not being subjected to Supplementary Audit than at present

But the sample which is subjected to supplementary audit yields very rich results. C&AG's comments arising from Supplementary Audit have significant effect on both increasing as well as decreasing the profit or losses of the company as the case may be. Additionally, many Companies revise their Accounting Policy as a result of audit observations. And sometimes these comments are of such profound nature that they result in changing an existing Accounting Standard of Institute of Chartered Accountants of India (ICAI). C&AG, Kaul has aptly described this function of C&AG as in the nature of a Peer Review. Comments are based on materiality and only such comments are placed in C&AG's Supplementary Audit that are really significant and material. A sample of results of 619 (4) audit is given below:

- (i) Taking first, the effect of supplementary audit on the profitability or losses of 168 companies (excluding Navratna



Companies) on whom audit comments were issued during the five years period 1999–2000 to 2003–04, there was a reduction in profit by Rs. 1845.52 crore (in 82 PSUs), increase in profit by Rs. 1,272.36 crore (in 18 PSUs); similarly, losses increased by Rs. 1573.93 crore (in 65 PSUs) and decreased by Rs. 23.67 crore (in 3 PSUs).

With regard to the accepted part and consequent revision of accounts by Management actual increase or decrease in Profit/losses was as under:

- ❖ Increase in profit Rs. 32.55 crore (in 16 PSUs)
- ❖ Decrease in profit Rs. 747.85 crore (in 53 PSUs)
- ❖ Increase in loss Rs. 219.81 crore (in 23 PSUs)
- ❖ Decrease in loss Rs. 10.10 crore (in 6 PSUs).

- (ii) The number of cases in which companies suo-moto decided to recast their accounts on the basis of C&AG's Supplementary Audit under 619 (4) of Companies Act were 98.
- (iii) C&AG's Supplementary Audit in the case of Navratna Companies revealed an enormous overstatement of profit and understatement of losses for the periods 1999–2000 to 2003–04. The overstatement of profit was Rs. 1835.23 crore in respect of 25 companies while understatement of losses for the same period was Rs. 2100.79 crore in respect of four companies only. This reflected a significant detection by the C&AG of overstatement of profit or understatement of losses.

On the basis of information given by MAB Ranchi, it was seen that as a result of their audit observation the management was able to effect substantial recoveries. In addition a major lacuna in rules relating to Leave Travel Concession for persons seeking VRS, the existing liberal provision was being misused by practically all employees which caused the company about a Rs. 1 crore outgo during the two years period only. On being pointed out this lacuna by Government audit, the company was able to save Rs. 15 crore in respect of 7500 employees who opted VRS subsequently.

The C&AG's supplementary audit has another great value. It enables the Parliament to take a fair view of the state of affairs of a PSU based on the report of the Statutory Auditor, the comments of the C&AG and reply of the management to those comments. It fulfils an essential ingredient in the accountability mechanism of the PSU to the Parliament.

In June 2007, C&AG issued a comprehensive guidance for use of PDCA & MABs and DGA (P&T) in exercising their judgment for determining the significance/ materiality for C&AG's comments under section 619 (4) of Companies Act. This was also prompted by the recommendation made by Dr. Arjun Sengupta Committee. The Guidance contains two parts—one dealing with C&AG's comments on Financial Statements and the other on C&AG's comments on Statutory Auditors' Report.

#### REVISION/ MODIFICATION OF ACCOUNTS/ ACCOUNTING POLICIES AS A RESULT OF 619(4) COMMENTS BY C&AG

An important impact of C&AG's comments under section 619(4) of the Companies Act is change in accounting policies of the concerned company. The companies often revise their accounting policies in line with C&AG's comments. In the year 2003–04 alone, 17 Central PSUs revised their accounts on the basis of C&AG's comments under section 619 (4). An idea of this can be had from the data available from some offices of MAB. For example, in the case of MAB, Hyderabad alone, about 9 companies revised their accounting policies based on the audit observations on the prevailing accounting policies. The number of such accounting policies which were revised either partially or wholly or introduced afresh numbered 23 in that office during the period 1991–92 to 2006–07.

A review of post 1994 comments of the C&AG reveals that comments of the MABs resulted in revision/ modification of accounting policy of ONGC in important areas like independent reserve estimation, time frame for status of exploratory wells in progress, impairment of assets, abandonment cost, rate of depreciation of processed platform, provisioning for inventory, non-moving inventory, etc.

An important contribution of these comments was that it focused on the need for independent reserve estimation where there were substantial variation between the figures of reserve estimation committee, figures adopted by ONGC for annual accounts and other technical reports. ONGC agreed to Audit suggestion for independent reserve estimation and in 2003–04 adopted the policy of independent audit of hydrocarbon reserves in all major fields. Supplementary audit comments on ONGC contributed towards issue of Guidance Notes on Accounting of Oil Exploration and Production Activities by ICAI in March 2003.

### CHANGES IN THE ACCOUNTING STANDARD/ GUIDANCE NOTE AS A RESULT OF AUDIT OBSERVATIONS

While documentation on all such cases, where, Guidance Notes were either amended or changed to accommodate the view point of Audit is not completely available, two notable cases of recent periods are detailed below:

In 2002, MAB, Ranchi<sup>12</sup> made a substantial contribution in redefining clearly the liability of the companies on account of retirement and other benefits to its employees. These liabilities are provided on the basis of AS-15 of the ICAI and guidelines prescribed in the guidance note 11 of Actuarial Society of India (ASI). The MAB noted for the first time a gross under—provision of liability on this score in the case of audit of accounts of SAIL for the year 2001–02. Subsequently, the adequacy of liability provided in the books of accounts in respect of about 90 PSUs under the audit purview of 12 MAB offices was also examined by the MAB, Ranchi where similar deficiencies were noted. As a result, a significant development took place, which could be ascribed as contribution of MAB office. AS 15 was found deficient in as much as it did not specify how assumptions such as discounting rate etc. were to be taken for working out accrued liabilities. The deficiencies were pointed out to President of ICAI for revising and updating them at par with International Accounting Standards, who intimated the MAB, Ranchi office of their intention to do so (ICAI has since revised AS 15 suitably effective from April 2006).

As a sequel to the above the ICAI on the basis of MAB, Ranchi taking up the matter also issued a clarification<sup>13</sup> to Statement of Standard Auditing Practices (SAP)<sup>14</sup> 9 on 'Using the Work' of an Expert which clarifies, the auditor's responsibilities, in using the certificate issued by the actuary in judging the appropriateness and reasonableness of assumptions made for determining such liability.

Simultaneously, MAB also addressed President, Actuarial Society of India and the Chairman, Insurance Regulatory and Development Authority (N. Rangachary) regarding suitable clarification in Guidance Note 11. Both of them thanked the MAB for his views and promised to hasten the process of amending Guidance Note 11 which was issued soon, the new Guidance Note is effective from April 2003. The implication of this revision of Accounting Standard was widespread covering not only PSEs but the entire Corporate India including Banking Companies, Insurance

Companies also where the impact of such provision was significant in monetary terms.

Similarly, comments under Section 619(4) by MAB, Mumbai, contributed to the Guidance Note on accounting for Oil and Gas producing activities issued by ICAI.

There were occasions when C&AG did not agree with the Auditor's certificate of true and fair view given to a company. A couple of cases noted are given below:

As a result of the Supplementary Audit, under section 619(4) of the Companies Act for the year ended 31 March 2005, in the case of accounts of IDBI Intech Ltd., C&AG in his comment on the accounts disagreed with the Statutory Auditor's Report, who, despite their several qualifications, concluded that accounts of the company were prepared on the concept of going concern and had chosen to give the company a clean chit by giving the opinion that subject to their qualifications the accounts gave a true and fair view of the state of affairs of the company, etc. The Audit opinion was that considering the substantive implication of various qualifications made by the CA, the certificate given by him was wrong and not in conformity with generally accepted accounting principles and the requirements of Auditing and Assurance Standard (AAS)-28. The C&AG, therefore, concluded that the opinion was not in conformity with these generally accepted accounting principles and (AAS)-28.

Similarly, in the case of India Tourism Development Corporation (ITDC) in respect of the accounts for the year ended 31 March 2006, the C&AG considered 'it was not proper on the part of auditors to have provided an assurance that the Annual Accounts presented a true and fair view'. This was because the auditors' qualifications had resulted in transforming the accounts from profit after tax of Rs. 45.79 crore into a loss of Rs. 24.30 crore. Despite such material evidence, the statutory auditors gave a true and fair view certificate.

#### INSTRUCTIONS CONCERNING 619 (4) COMMENTS

From time to time, several instructions on supplementary audit—section 619 (4) audit—have been issued by Headquarters. Some of the important instructions are recounted below:

The question whether C&AG can take up the audit of annual accounts simultaneously with the statutory auditor has often been discussed and debated in Headquarters. The practice prior to 1972

was that simultaneous audit of accounts could be taken up by C&AG. In August 1972, in a communication to field commercial audit offices, Headquarters asked them to discontinue this practice. It prescribed a somewhat different system while keeping the basic process intact. It said that on receipt of a copy of accounts from the management, C&AG's audit could commence simultaneously with the statutory auditor but audit observations should not be released to the company. In April 1997, these instructions were reiterated with the renewed emphasis that preliminary comments of audit should not be released to the management or statutory auditor. It also emphasized need for constant interaction with statutory auditors and the management.

In July 2001, Headquarters addressed field offices on the subject of window dressing their accounts by a number of PSUs and circulated to them a list of 'possible ways by which the Companies manipulate their profits'. The field offices were asked to critically examine the areas in accounts where possibility of window dressing was more.

Since 1990 procedure for issue of comments/ Nil comments on the accounts of Government Companies under Section 619(4) of Companies Act has been reviewed at least on three occasions and changes introduced. The issue was who would issue 'Nil' comments i.e. field MABs on their own or after approval of DAI (Commercial). Prior to August 1992, Nil comments were issued by MABs on their own without seeking approval of DAI (C). In August 1992 a decision was taken that proposal for 'Nil' comments would be sent to the Headquarters for their scrutiny and decision. In March 1996 the position obtaining prior to August 1992 was restored i.e. for Nil comments, no approval of Headquarters was required. However, in September 1996, just after six months of the above order, the practice of sending proposal for approval of Nil comments under Section 619(4) was restored. Instructions were issued again in March 2002 for issue of 'Nil' comments by MABs without approval of Headquarters.

In October 2006, Headquarters addressed all the MABs and DGAP&T on the subject of issue of Management Letter to companies in case of supplementary audit. The main thrust was that management letter to companies should be made a standard practice where MABs could include significant accounting and disclosure issues, which posed a credible risk to fair reporting.

In March 2007, Headquarters reviewed the then prevailing formats for issue of comments under section 619 (4) of Companies

Act in the light of national and international standards on reporting by the auditors. In line with these, the formats of following were revised and circulated to all the field offices:-

- (i) Revised Format for issue of 'Comments'
- (ii) Revised Format for issue of 'Nil' Comments.
- (iii) Revised Format for issue on 'Non-Review Certificate'
- (iv) Revised Format for issue of 'Nil comments after Revision of Accounts'
- (v) Revised Format for issue of 'Comments after Revision of Accounts'

In revising these formats, the Department also took into account the accepted best practice that the assurance process of financial statements of an entity should clearly indicate its objective, scope and legal requirement.

Audit under section 619(4) by the C&AG was in many cases not being done within the specified time frame and instances of delays were there. In September 2002, Headquarters issued directions to all the MABs where, on the basis of an analysis done of time taken by each MAB for completion of audit of Annual Accounts of Government Companies, it was reiterated strongly that the total time to be taken for communication of final comments of the C&AG to the company should not be more than six weeks from the date of receipt of the accounts by Audit.

#### IMPROVEMENT IN FINANCIAL REPORTING BY PSUs AS A RESULT OF AUDIT OVERSIGHT BY C&AG.

The Headquarters issued instructions in March 2006 and March 2007 emphasizing on the importance of developing synergy with the Audit Committee of the PSUs and the concerned statutory auditor for an overall improvement in financial reporting by PSUs in the interest of better corporate governance. In March 2007, Headquarters issued instructions that aimed at improving financial reporting as a result of audit oversight by C&AG. Amongst others, these emphasized that audit party should acquire sufficient knowledge of the concerned PSUs business risks. A suggestion given related to reference of such cases to Expert Advisory Committee by PSU or MAB involved if they perceived any ambiguity in the interpretation of accounting policies/accounting standards. Audit should examine the relevance, necessity and possibility of eliminating the redundant, insignificant and irrelevant

accounting policies and Notes to Accounts in respect of PSUs that give extensive disclosures through accounting policies and Notes to Accounts. In this context, it cautioned that some items under Notes to Accounts could be construed as camouflaged qualifications while some important information like off Balance Sheet items and important accounting policies may not have been suitably disclosed. An important point was that for audit in a computerized environment, besides judging the capability of statutory auditor to conduct such audit, if required, an official with IT audit experience may be included as a member of audit team conducting supplementary audit. Only material and significant comments were to be considered for issue to the management (the general parameters for determining the materiality have since been developed and issued to the field offices for guidance).

There were also instructions about the qualitative improvements in statutory auditors' reports. In an important instruction, Headquarters asked the field offices to communicate through a show cause memo, any serious lapse on the part of statutory auditor that reflects poorly on his performance.

Additionally, these should also be suitably reflected in the performance evaluation of the statutory auditor.

These instructions also stipulated that field offices, while forwarding the draft comments under 619 (4) audit to the Headquarters should also state:

- (a) Whether any Management Letter to the PSU with a copy to statutory auditor was being issued as per instructions in this regard by Headquarters.
- (b) Whether any letter or memo to the statutory auditors as mentioned in the preceding paragraph was being issued for any serious lapses on their part.

#### DHARAM VIR COMMITTEE REPORT

On the directions of the C&AG, a team of officers headed by Dharam Vir (then Member, Audit Board, New Delhi) was set up to do a study and report on the improvements in the efficiency of Commercial Audit Wing; the Committee in their study covered the system of comprehensive appraisal, mini-review and draft paragraphs and based on the recommendations of the team, Headquarters issued instructions in September 1990 for systems improvement in these areas in the Commercial Audit Wing. These instructions, inter-alia, contained guidelines for the qualitative

improvements in accounts audit under Section 619 (4) of the Companies Act, processing of draft paragraphs specially with reference to the period of the event or transaction happening and monetary effect of the audit observation and mini reviews. On comprehensive appraisals, the Report was critical of the unduly long time taken for the completion of the appraisals and remarked 'a time frame of 7-8 years for an appraisal is excruciatingly long'. It laid down new time frame for the completion of comprehensive appraisals, namely, two years and for bigger undertakings which were multi units (BHEL, ONGC, etc.) a three years time frame was prescribed. The study, however, did not cover accounts audit issues in detail. This was to follow soon more as a fall out of Securities Scam and JPC Report on that in early nineties.

#### JPC REPORT ON SECURITIES SCAM

The Joint Parliamentary Committee (JPC) was constituted on 10 August 1992 with Shri Ram Niwas Mirdha as Chairman to go into the irregularities and fraudulent manipulations in transactions relating to securities, shares, bonds and other financial instruments that had rocked the Stock Exchanges and examine the role of Banks, Stock Exchanges, Financial Institutions and Public Sector undertakings in transactions relating thereto 'which have or may come to light'. The Committee was also to fix responsibility of concerned persons, institutions etc. involved in such transactions and further to identify the misuse, if any, and failure or inadequacy of control mechanism and supervisory mechanism. The Committee was also to make recommendations for improvements in the system for elimination of such failures in future and also make appropriate recommendations regarding policy and regulations to be followed in future. The Committee submitted its report on 21 December 1993 to the Parliament. Of the various issues gone into by the Joint Parliamentary Committee, those that dealt with Statutory Audit of Banks and Public Sector Undertakings and recommendations made in that regard were of relevance to the C&AG. The Government forwarded, as desired by the JPC, to the C&AG, specifically paragraphs 10.36, 10.37 and 10.38 of the Report of the Committee for taking appropriate action as recommended by them.

JPC suggested that C&AG (as also Department of Company Affairs) should examine statutory auditors' reports of PSUs etc. involved in the irregularities and take appropriate action against



auditors who were negligent in the performance of their duties. In paragraphs 10.37 and 10.38 where the JPC dealt with supplementary or test audit of company accounts by the C&AG, its finding was that there were obviously some shortcomings in the methodology of audit and these deserved to be examined. The Committee, in their summary section repeated that there were grave shortcomings in the objective and methodology of audit as practiced 'at present'. The Committee, on their own, addressed some of the issues concerned with audit system and suggested that with a view to achieving the objective of effective audit, statutory amendments be made wherever considered necessary.

When the Headquarters received the communication from Banking Division (January 1994) asking that observations/ conclusions/ recommendations of the Committee (at Sl.No.69 and 70 of their Report) be dealt with by C&AG for appropriate action, a thorough analysis of the Report vis-à-vis the role of statutory auditors and the Government Auditors was conducted in the Headquarters. A component of the Report on which action by C&AG was identified related to action against the statutory auditors for their failure to report the irregularity in the transactions and investments. For this purpose, an internal Committee of the Headquarters was appointed to look into the gravity of the negligence of auditors. The Committee finally identified 25 firms of Chartered Accountants to be negligent in their duties in pointing out the irregularities and recommended non-entrustment of audit to these companies for specified number of years i.e. 2 years and one year. For companies which were guilty of negligence but not serious enough, warnings were issued. Some companies were left out of action because the Auditors in these cases had discharged their duties as per the requirements of Companies Act and Statement on Standard Auditing Practice. The recommendations of the Committee were accepted by the C&AG.

#### SHORTCOMINGS IN THE METHODOLOGY OF AUDIT AND KUPPUSWAMY COMMITTEE REPORT

JPC's observations about existence of shortcomings in the methodology of audit was taken very seriously by the Department and a committee of senior officers under the chairmanship of K. Kuppuswamy the then ADAI was set up to review and suggest measures for improvement in the methodology of audit of accounts of Government Companies and Corporations and also recommend

changes to be made for in-service training of commercially qualified staff.

Kuppuswamy Committee Report is a comprehensive set of instructions on the audit of Annual Accounts of Government Companies and Corporations. In that sense, it is a supplement to the Commercial Audit Manual. In fact, when this report was given (December 1994), Headquarters instructed that the check list prescribed in the Manual on the conduct of Supplementary Audit was to be used only as an illustrative list while the check list prescribed by the Committee was to be used as a 'must guide' for the conduct of Supplementary Audit. Action on the report of the Committee was taken and suitable instructions on that basis were issued in December 1994 for implementation of their recommendations.

#### AUDIT BOARD FOR CENTRAL PSUs

One very significant development of the period was a relook at the Audit Board Mechanism by the C&AG.<sup>15</sup>

The Audit Board mechanism for the appraisal of the working of Central Public Sector Undertakings introduced in 1969 consequent to the recommendations of Administrative Reforms Commission (ARC) has been reviewed from time to time as regards its efficiency and efficacy in conducting comprehensive Performance Appraisals of companies/corporations. The Audit Board mechanism did work well for several years after its introduction. In 1970s and thereafter when a large number of Audit Appraisals by these Audit Boards were prepared which, subsequently, on C&AG's approval were issued mostly as his standalone Audit Report.

Comprehensive appraisals of various government companies/corporations by the Audit Board had several visible advantages: first, the Board had the benefit of the involvement of two outside technical experts; their presence in the deliberations on the audit appraisals lent certain degree of authenticity especially where the subject matter of audit appraisal was overwhelmingly of technical nature. They also, to a large extent, were able to articulate in the Audit Board the executive perspective of any decision since they had gone through that process in their normal job. Overall, their presence gave good deal of credibility to the audit findings.

The second big advantage, Audit Board mechanism provided, was the unique system of interaction at the highest level amongst the three principal parties involved namely Audit, the Management

of the company and the Ministry/Department concerned. The two part discussion of Chairman Audit Board first with the top management of the company and later with the Secretary of the Ministry/Department concerned yielded rich results and often moderated the final audit opinions in quite a few cases. There were several cases where corrective action on some of the points brought out on the draft audit appraisals was promised by the Secretary of the Ministry or the Chairman of the Company in the meeting itself and action followed soon thereafter. And finally, in case of disagreement, these meetings ensured that the opinion of the highest functionaries of the company and the government get faithfully recorded in the Audit Report. These meetings were more like the exit conference now introduced by Performance Audit guidelines with the added advantage that this conference was invariably held with the Board of Directors of the company and the Secretary and his top management team of the Ministry—the system was so designed that a meeting below this level was not entertained.

With all these merits, the Audit Board appraisal system suffered with the passage of time from one great factor namely the long time taken in finalizing the Audit Report. Here again, quite often, one of the contributory factors was non availability of the Secretary and his team for the formal Audit Board meeting—at times, this could delay the matters even upto several months. As a result, flow of these appraisal reports dwindled and time taken for finalizing the appraisals became unduly long.

C&AG C.G. Somiah and V.K Shunglu and before them C&AG T.N. Chaturvedi had expressed concern at the abnormal delay in finalizing comprehensive appraisals. C&AG, Chaturvedi and after him Somiah made special efforts, by revamping Commercial Audit set up, to speed up the process and due to these special efforts the number of such Audit appraisals again went up (the details are given elsewhere in this Chapter) in the late eighties and early 1990s. The momentum however, could not be sustained for very long and there were limits to turning out large number of such appraisals. By mid-nineties, the view generally held by the C&AGs was that comprehensive appraisals of the Public Sector Undertakings by Audit Boards was time consuming on account of various reasons and this took away the value of these appraisals; in the circumstances a need was felt to have a hard look at the system. The working rule around the end nineties was that no new comprehensive appraisals be taken up instead what used to

be called 'Mini-Reviews' on specific topics or areas of the working of the company, should be done by the Commercial Audit wing. In practice, Audit Board Mechanism, in the original sense, was a forgotten institution towards the end of 1990s. The present C&AG V.N. Kaul also realized that 'there is a need to effect changes in the approach of audit from conducting comprehensive appraisals of PSUs to focusing on critical areas of concern in their performance'. As part of his reform process, Headquarters issued fresh instructions on finalization of appraisals through the mechanism of Audit Board, first one in a circular of 30 May 2005 and the second on 7 November 2005. Apparently, the C&AG was thinking deeply about the efficacy of existing utility of the Audit Board mechanism. The May 2005 instructions were more a kind of internal directions regarding conducting audit of PSUs through mechanism of Audit Board. November 2005 instructions drastically re-organised the structure and composition of the Board and brought out basic changes in the approach of audit. In terms of these instructions, the Audit Board was to be a permanent Board for Central PSUs with 4 permanent positions viz. DAI (Commercial) as Chairman, Director General (Performance Audit), Director General (Commercial) and Economic Adviser as Members. Two members were to be nominated from amongst the MABs for a period of one year on rotation basis and the Principal Director conducting the performance audit was to be a special invitee. The Board would, on the basis of strategic audit plan, finalize the selection of topics for performance audit. It would focus on thematic issues and not follow the earlier approach of comprehensive appraisal which covered practically the working of all the areas of PSUs. The thematic studies were to be designed on critical issues and these issues could pertain to a particular PSU or could horizontally cut across several PSUs.

Another important decision was to associate the technical experts by co-opting them as special invitees. The Audit Board would conduct performance audit under two broad categories viz. category I where its role was limited to selection of topics. The concerned PD of Commercial Audit would carry out performance audit in terms of Performance Auditing Guidelines and as per time schedule given in 30 May circular. Category II performance audit related to those topics which would come out as standalone reports. Audit Boards would play bigger role in these Reports. They would follow a three stage process viz. selection of topics, approval of guidelines etc. and in the third meeting finalize the audit report

with representative of Ministry/Management. The new system was to be followed from the Audit Report of 2007.

IT audits concerning PSUs would not be included within the scope of Audit Board for Central PSUs and these were to be processed in consultation with DG, iCISA, Noida.

An interesting point in regard to the above is that all these decisions contained in the Circular of November 2005 were taken in consultation with the Department of Public Enterprises and that lends it much more credibility and inclusiveness.

#### AUDIT REPORTS (COMMERCIAL)

Audit Report (Commercial) as a separate volume commenced in 1963 relating to the year 1961–62 in the case of Union Government. Before that C&AG's observations of his audit on Government Commercial undertakings were a part of the Central Government Audit Report (Civil).

The Audit Report (Commercial) till 1968 contained C&AG's audit findings on the following categories of Government enterprises:

- (i) Government Companies
- (ii) Statutory Corporations
- (iii) Departmentally managed Commercial undertakings

From Audit Report 1969, C&AG's audit findings on departmentally owned undertakings that were earlier part of Audit Report (Commercial) were taken out from there and became a part of Audit Report (Civil).

The important change in Audit Report 1970 related to the Performance Appraisals by Audit Boards that were set up with effect from 1 April 1969 under the supervision and control of the C&AG of India for Comprehensive Appraisals of the working of PSUs. In 1970, for the first time 10 such appraisals appeared as separate volumes of Audit Report Commercial as Part-II to Part-XI. From hereon, these standalone Performance Appraisal Reports became a prominent feature of Audit Report Commercial till their decline in late 1990s leading to eventual restructuring of Audit Board mechanism and abolishing the comprehensive appraisal system in 2004.

Apart from standing reports each year, the variable factor in increasing or decreasing the number of Audit Report (Commercial)/Reviews presented during a year was the standalone Performance

Appraisals of PSUs based on the Audit Board mechanism. These were essentially performance audit Reports. In their hey days performance appraisal Reports (Commercial) presented to Parliament during a year numbered as many as 21. The decline in their number began after 1996 when standalone performance appraisal Reports dried up. Partially, it was due to the fact that the appraisals were aiming at looking into the entire range of activities on the performance of an entity and as a result it became rather unwieldy and cumbersome to produce good appraisals. It was also dwindling due to the fact that most of the bigger entities had already been appraised in Audit, in some cases more than once. And finally, the mechanism of Audit Board was not proving as effective and successful as were expected of them vis-à-vis timely output, getting better auditee response, or even contributing significantly to the value addition to management.

Both the C&AG C.G. Somiah and V.K. Shunglu had their misgivings about the efficacy of these comprehensive appraisals. Perhaps a time had come to change the system. A beginning was made in C&AG's Shunglu's time by practically giving up comprehensive appraisals and producing more and more what were called mini type of reviews on some specific aspects of the working of an undertaking. These Reviews produced during the period 1995–2002 were better appreciated and were more useful to the auditees. The practice of preparing performance appraisals on specific aspects of working of PSUs still continues and is now the dominant system of Performance audit.

Formally, the entire system was overhauled by C&AG Kaul in 2004 when he decided to do away with the prevailing Audit Board mechanism and its focus on comprehensive appraisals of PSUs. He restructured the Audit Board and redefined its mandate as already detailed in the preceding title.

#### POST 1990 DEVELOPMENTS IN AUDIT REPORTING

In September 1990, Headquarters issued a comprehensive set of instructions regarding systems improvement in the Commercial Audit wing. These instructions had the approval of Comptroller and Auditor General. Amongst the more important of these instructions were:-

- ❖ Raising limit of annual accounts audit under section 619(4) of the Companies Act from Rs. 20 crore (paid up capital or turnover) to Rs. 50 crore.

- ❖ All draft paragraphs which included transactions of six to eight years before the year of Report and where the monetary impact was less than Rs. 5 lakh should not be processed for Audit Report (this excluded cases of serious system deficiencies or misappropriation or fraud or violation of foreign exchange regulations).
- ❖ Mini review must be finalized within the time frame of one year to 18 months. Regarding Appraisals, the instructions commented that many of them were about seven to eight years old already which, it said, was excruciatingly long. Therefore, the decision was that Appraisal should be finished within the maximum period of two years barring for bigger undertakings where a period of three years was given. A detailed procedure and a stepwise time frame to achieve the objective was also given in these instructions.
- ❖ It was also desired that an overview or summary of the mini review or Appraisal should be sent along with the draft report to the Chief Executive of the Management/Secretary of the Ministry for their quicker understanding of main features / thrust areas without even going through the main volume.

The initial years of 1990s are marked by large number of Audit Reports (Commercial) presented to Parliament but just two years before 1990, that is in the year, 1988 no Audit Report (Commercial) could be presented to Parliament. A very vigorous drive was launched from 1990 onwards to get over the problems and in the first 4 or 5 years of 1990s there was a big turnover of Audit Reports (Commercial), specifically of the Performance Audit Reports. 1994 was relatively dry year because only one Audit appraisal was presented to Parliament. In 1989 Audit Report (for the Financial Year 1988–89), out of 13 Audit Reports (Commercial) presented to Parliament 10 related to Performance Audit Appraisals/ reviews, similarly, for the Financial Year 1990–91, 19 audit reports were presented during the various periods in 1992 of which 16 related to Performance Audit Appraisals/ reviews for the year 1991–92, out of 14 Audit Reports (Commercial) presented in various sessions of Parliament in the year 1993, 11 related to Performance Audit/ Review Reports.

1995 again was bumper year when 24 Audit Reports were presented to Parliament during 1995–96 and 1996–97 out of which, all except 3, related to Performance Audit Appraisals/ reviews. From 1996 onwards till 2000, Performance Reports dwindled in

number—on an average every year 3 or 4 Audit Reports were presented to Parliament but from 2001, Performance Audit Appraisals were practically given up.

In 1990 there were 3 Standing Reports on Commercial Audit and the structure of these Audit Report (Commercial) was: Report No.1—Introduction, Report No.5—Resume of Company Auditors' Reports and comments on Government Companies, Report No.7—Audit observations on Individual Topics of Interest.

In 1993, the titles were slightly changed viz. Report-1—Review of Accounts, Report-2—Comments on Accounts, Report-3—Audit observations.

The Structure of Audit Report (Commercial) in the year 2001 was: Report-1—Review of Accounts, Report-2—Comments on Accounts, Report-3—Transaction Audit Observations, Report-4—Review on activities of some PSUs.

From the year 2003, a 5<sup>th</sup> volume of Audit Report was added, exclusively devoted to PSUs in Telecom Sector. This Report is now a standing feature of Audit Report (Commercial). C&AG, Kaul desired that each year a sector specific review of PSUs should be brought out, apart from Telecom. In subsequent years, sector specific Reports have been brought out e.g. in 2004, an Audit Report on Steel Sector, in 2005, an Audit Report on Petroleum Sector PSUs were brought out. Same year, an important Review on Golden Quadrilateral Project of NHAI was brought out—A resume of the Review appears in Appendix 'B'.

From 2006, Audit Reports were divided into (1) Transaction Audit Reports, and (2) Performance Audit Reports. The Format of the former Report has been changed from the Audit Report 2007. The new Report called Financial Reporting by PSUs amalgamates two former Reports viz. Review of Accounts and Comments on Accounts. The new Report has only four Chapters viz.:

1. Financial Performance of Public Sector Undertakings
2. C&AG's oversight role
3. Corporate Governance in Government Companies
4. Environmental aspect and sustainability reporting

A colour code scheme now distinguishes these Reports. The colour code is unique and common to all the Audit Reports. Transaction Audit Reports (now called Compliance Audit Reports) are called 'Yellow' Series Reports because the front cover of these Reports and back has Yellow border; Performance Audit Reports



have two colour Schemes. Standalone Performance Reports are 'Red Series' Reports while the 'Blue Series' Performance Audit Reports contain reviews on several themes/ companies.

#### MEASURING AUDIT EFFECTIVENESS—ALLOTMENT OF MONEY VALUE FOR AUDIT REPORTS (COMMERCIAL)

Headquarters issued instructions in the year 2003 regarding allotting money values to various Paras and Reviews included in the Audit Reports as per a matrix devised for each functional wing's Report. These instructions were reviewed from time to time to bring more refinements in matrix and correct distortions that had come in assigning money value to Paras/ Reviews. In February 2006, Commercial Audit Wing issued fresh directions on the subject—this became necessary because of tendency, in many cases, to inflate the money values—in several cases credit was taken and money value assigned to audit paras on Transmission and Distribution losses or similar type of paras. The 2006 Circular streamlined the system and laid down the basic principle that the money value was to be assigned only to those paragraphs where Audit effort on contribution is evident. No money value was to be assigned to paragraphs based on the data obtained from the PSU or Government (records) and incorporated in the Audit Report as factual statements or statistical information or without audit findings based on analysis. The letter listed out cases which should not be assigned money value. These included, amongst others, paragraphs on: excessive transmission and distribution losses, shortfall in production of certified seeds, on potential loss of revenue, on amount blocked, (credit for interest amount on such amount can be taken), subjects or matters that had already come to knowledge of Department/ PSU either through their internal audit wing or otherwise. There were some other examples also listed in the letter.

From the year 2004–05 draft Audit Reports, C&AG made it mandatory for the Commercial Audit Paras to indicate the money value of paras together with the classification of para viz. A1, A2, R1, R2, etc.

#### POST REVIEW OF AUDIT REPORT MATERIAL

The Headquarters carries out an analysis—a kind of evaluation of the Audit Report material sent by various offices after the approval of the Audit Report(s). This analysis is duly conveyed to the

concerned offices. For instance in March 2006, analyzing the Report No.12 (Commercial Audit) DAI (Commercial) pointed out to MABs that while the Audit Report contained 145 paras, 107 paras were dropped at Headquarters for reasons such as lack of focus, issue discussed was old-outdated, or not material or even premature. Many paras, lacked proper analysis and there were some others that were sub-judice. Individually each office was intimated parawise detail of the reasons for which para was dropped.

This letter then reiterated some of the issues which the MABs were asked to give attention in order to further improve the quality of Audit Reports. Some of these were: while sequence of events were narrated, no analysis was done as to 'why' such lapses occurred; hence there was, in no way, any value addition for the management; Audit should give more attention to cases of fraud/ embezzlement, operational issues and system deficiencies, internal control, etc. Paragraphs dealing with blocking of funds, idle investment, transmission losses, etc. should not be attempted as a matter of routine unless these involve huge financial (interest) loss or specific management failure. Focus should be more on core activities of the entity. The letter also pointed out that Style Guide instructions were largely ignored. The MABs were asked to follow these strictly.

#### AUDIT OF FRAUD & CORRUPTION

In regard to audit of fraud and corruption, fresh instructions were issued by Audit Wing in April 2006 and on its receipt CA Wing addressed their field offices in June 2006 and August 2006 as a follow up of these instructions.

Approach of audit towards detecting and reporting of cases of fraud and corruption is dealt with in Chapter 4.

#### AUDIT MANUAL

The question of having a comprehensive Audit Manual for Commercial Audit is a long pending issue in the Commercial Audit Wing. The task of framing a Manual was given to a couple of officers and eventually the updated Commercial Audit Manual came out in 1993 as second edition. The first Manual was issued in 1967. The letter from Director (Commercial) dated 14 December 1994 which contains the detailed instructions of the Kuppusamy Committee Report regarding audit under 619(4) of the Companies Act including the detailed check list is currently the most exhaustive check list.

At present, there are two Commercial Audit Manuals, one for the audit of Central Commercial Undertakings for use by MABs and the other one called Commercial Audit Manual for State Accountants General which is for the use of State commercial undertakings which was issued in 1994. Apparently, there was a kind of dichotomy in this kind of arrangement because the commercial audit principles including the Check List would be the same whether the undertaking was of the Central Government or of the State Government. Recognizing this fact the present C&AG issued directions that a combined Manual for the use of both Central Commercial Audit and State Commercial Audit (AG offices) should be prepared. Currently the Manual is under preparation. There are separate Commercial Audit Manuals issued by various MABs/AG (Commercial) offices which in detail deal with the audit of the Public Sector Undertakings that are in their audit control.

Between 1993 and 2006, a number of developments in Commercial Auditing domain and in Corporate world took place. Therefore, it was necessary that Commercial Audit Parties are equipped so deal with these new developments. For this purpose from time to time, instructions were issued by the concerned DAIs. These include August 1992 instructions issued by N. Sivasubramanian, who was Deputy C&AG (Commercial) at that time regarding review of Commercial Accounts. In March 1996 instructions were issued by DAI (Commercial), B.P. Mathur which deals with issues on approach of audit to regularity audit, systems audit, reviews, audit plan, issue of draft paras to the Ministry and accounts audit, Inspection Reports and control over audit parties. In July 1996, he also issued instructions on the format for Review of Accounts. In between, and subsequent to these letters clarificatory instructions on accounts audit were issued. The system of issue of Review of Accounts has been dispensed with in August 2006. There is some apprehension that because of the fragmented issue of instructions, many field offices would miss out some of these. This is another good reason why a revised fully updated comprehensive manual should be issued now.

#### PROPOSALS REGARDING AMENDMENT TO COMPANIES ACT

*Concept paper on Companies Act:* In recent times, Government has shown its eagerness in the amendment to Companies Act in the wake of several corporate scandals that came to public notice

during nineties, like Enron, Wordcom etc. The Government reacted by appointing Naresh Chandra Committee to go into the issues of Corporate Governance in the light of those big scandals and specially examine the Auditor—Company relationship. More important, Government (Ministry of Company Affairs) circulated a Concept Paper on Company Law in August 2004. This Paper had 289 Sections, in contrast to 781 Sections and 15 Schedules in the existing Act. The object of this Paper, which was termed as an 'Approach Paper' to the introduction of a new Bill in Parliament, was to elicit opinion on the paper.

The Concept Paper when examined in Audit Department revealed that the relevant provisions in the existing Act relating to Audit of Government Companies, and the role of C&AG prescribed in the existing Act had been drastically curtailed, in fact more or less omitted. The corresponding sections to existing section 619(3) to (5) in the new document did not have any provision regarding issue of directions to statutory auditors, supplementary/ test Audit by C&AG and placement of C&AG's comments in Annual General Meeting (AGM) along with Auditors' Report. And yet, section 254 of the Concept Paper Document, (corresponding to Section 619 (A) of existing Act) require that comments of the C&AG upon, or supplement to, the auditors' report be placed in Parliament/ State Legislature. This contradicting position made the situation more confusing—apparently, the Concept Paper was drafted with some haste hence these contradictory provisions.

The Audit Department's reaction to the proposed new Act as contained in the concept paper was on expected lines as far as restoration of the existing provisions of the Companies Act namely Section 619 (3) to 619 (5) was concerned but it went beyond it and wanted an expanded mandate for the C&AG in the audit of disinvested companies where Government residuary share was still 25 per cent or more. In advocating this clause for the new Act, the C&AG was guided by the principle of 'substantial' stake of Government in these undertakings (provision would be in line with the current provision for the C&AG's Act in section 14/ 15 where C&AG has a definite role to play in the audit of bodies and authorities where the Government has substantial contribution by way of grants or loans). Keeping these entities out of C&AG's ambit, obviously, leaves 'big gap' in the accountability arrangements for such companies in which large public funds are invested.

Meanwhile, the Ministry of Company Affairs in March 2005 intimated the appointment of an Expert Committee under the Chairmanship of Dr. J.J. Irani for advising the Government on the new Companies Law. One of the sub-groups which the Committee had constituted to facilitate opinions, was on audit and accounts which was set up to examine the provision relating to these in the proposed Act. The Committee had desired that a representative of the C&AG could also attend the meetings of the sub-group.

When the meeting of C&AG's representative with the sub-group was held (in March 2005), it had laid out three issues for discussion on the subject. These were:

- ❖ In view of the overriding nature of provisions of Section 619 (3) for issue of directions by the C&AG to auditors of Government Companies, how the provisions of the Act relating to Accounting Standards would be complied with by the Government Companies? Should there not be uniformity on governance norms for all companies whether private sector or Government?
- ❖ Further, whether the provisions for compulsory appointment of auditors by the C&AG should be applicable only in respect of Government Companies which are wholly owned by the Central or State Government? In other words, whether the provisions of Section 619 B should be reviewed?
- ❖ Should there not be a specific provision that in cases where C&AG has to appoint auditors, the process should be completed within 90 days of start of the Financial Year? In case auditors are not appointed by the C&AG within the specified period, shareholders can appoint auditors.

All the issues were such as had been raised several times earlier and from time to time clarified. It was apparent that the composition of the sub-group and their sectoral interests were at play in raising such issues again. These misgivings of the department of Company Affairs were clarified by C&AG's representative<sup>16</sup> in the meeting itself. The allegation that directions under Section 619 (3) (a) were contradicting the independent functioning of the Chartered Accountants as per ICAI Auditing Standards and Companies Act was a gross (if not deliberate) mis-interpretation by them as C&AG's directions are on matters that are beyond the normal checking in the Annual Accounts audit by Statutory Auditors. It was, therefore, satisfying when after all clarifications, during the meeting, the Department of Company Affairs informed C&AG's representative

that the provisions relating to C&AG audit would continue to exist as they were in the existing Act<sup>17</sup>.

However, as the subsequent developments showed this was not to be. When the Irani Committee Report was out C&AG's audit was practically given a go by as far as PSUs were concerned. The C&AG had these fears and he had earlier<sup>18</sup> cautioned that a close watch must be kept on the development in this matter lest dilution of accountability of PSUs might occur. The Committee had, as already mentioned above, more or less, recommended abolition of C&AG's audit of PSUs and C&AG would not, therefore, be in a position to submit any Report to Parliament for COPU's consideration. In one word the Committee in their wisdom had recommended abolition of all systems and procedures of accountability to Parliament through C&AG's Reports.

The concern of the Department over these recommendations can be gauged by the fact that the C&AG chose to address the Prime Minister in the matter to brief him on the history and rationale of C&AG's audit of Government Companies in India.

His letter gave a background account of C&AG's auditory control. He strongly rebutted the rationale given by Irani Committee for their recommendations. Very briefly, the C&AG pointed out to the failure of the Irani Committee to appreciate the philosophy of Parliamentary Control over Public Funds invested in these PSUs and a need for public accountability to Parliament. He also quoted at length the recommendations of the PAC which led to incorporation of Section 619 B in the Companies Act, 1956. To the criticism that supplementary audit by C&AG is duplication, the C&AG's view was that supplementary audit was in the nature of a peer-review to give assurance regarding quality of audit or compliance of directions issued to Statutory Auditors. He also gave examples of fruitful results of this audit by quoting facts and figures on its impact on profit/ losses of PSUs, on accounting policies and on guidance notes. He also mentioned about C&AG's Transaction Audit and Performance Audit (which are outside the purview of Statutory Auditors).

Finally, the C&AG pointed out to the trends worldwide which emphasized a larger role for public oversight on Public Limited Companies to ensure greater accountability and transparency. In USA, a Public Accounting Oversight Board exists to ensure greater accountability overseeing the audit of Public Companies. In Britain, C&AG heads the Professional Oversight Board for Accountancy. In India, the institution of C&AG, which is a constitutional and

independent authority fortunately performs such oversight functions. Therefore, he concluded that there was a need to further strengthen this institution rather than dilute it.

The C&AG also rebutted the arguments given for taking away his jurisdiction on 619(B) companies or deemed Government companies as they are often called. A factually incorrect position in the Irani Committee Report was that the direction issued by the C&AG to Statutory Auditors was not in accordance with accounting standards, the auditors might be required to mention the same in the notes on accounts. It was explained that the scope of the directions issued by the C&AG to Statutory Auditors was not in conflict with accounting standards because it goes beyond them to include areas like corporate governance, internal controls and economy and efficiency of company's operations—aspects that are not the concern in annual Accounts Audit.

Concluding, therefore, the note said that existing provisions of Sections 617 and 619 relating to audit of Government Companies by C&AG should be retained as such in the proposed amended Companies Act.

The issue of C&AG's role in the audit of Government Companies is still to be finally decided, since the amended Company's Act is yet to be tabled in Parliament.

#### DR. ARJUN SENGUPTA COMMITTEE

Another report that was discussed and examined very closely in C&AG office was the report of Adhoc Group of Experts (AGE) popularly also called Arjun Sengupta Committee. It was constituted by the Ministry of Heavy Industries & Public Enterprises to consider issues relating to autonomy, delegation of financial powers, etc. of Central Public Sector Enterprises<sup>19</sup>. The AGE was constituted in pursuance of the National Common Minimum Programme of the Government that had 'pledged to devolve full managerial and commercial autonomy to successful profit making companies operating in a competitive environment'.<sup>20</sup>

In June end 2005, Secretary, DPE, while forwarding a copy of the Report of the AGE to C&AG, requested for C&AG's comments/ views on recommendations made in the Report that related to audit of Government Companies.

The Report of the AGE, in summary, generally made a pitch for whittling down C&AG's powers to audit Government Companies. It held that C&AG audit led to delay in finalization of

accounts audit; his audit is a duplication of audit done already by statutory auditor. It also cast a doubt on the authority of C&AG for conducting transaction/ propriety audit.

The AGE made several other recommendations: it said C&AG may issue revised guidelines to statutory auditors and rely mainly on their Report. Test/Supplementary Audit should be done only in exceptional cases rather than as a routine exercise and pleaded that appointment of statutory auditors be made at the earliest (in the beginning of the year). It also wanted C&AG to give suitable directions for consultation with statutory auditors at appropriate levels so as to minimize the need for supplementary audit. Finally, it wanted that only malafide, intentional mistakes, frauds, gross negligence or willful ignorance of advice/ suggestions should attract Audit observation. Overall performance of the company should be the guiding criteria rather than individual commercial decisions.

The C&AG, on receipt of this letter, appointed a Task Force of Senior Officers<sup>21</sup> under the chair of DAI (Commercial) to deliberate upon the specific issues arising from Sengupta Committee Report. DAI sent a point-wise reply to the Ministry in July 2005 where he suitably and convincingly rebutted each point. To the doubts regarding C&AG's powers to do transaction audit/ propriety audit the letter said that accounts and transactions audit were complementary in nature. C&AG has to view these functions in totality. C&AG also has authority to determine the scope and extent of audit as per Section 23 of C&AG's (DPC) Act. He can, therefore, undertake performance audit of companies.

Regarding delay in finalization of audit of accounts the letter pointed out that it would not be appropriate to attribute this delay in certification of accounts to C&AG's audit under Section 619(4) because his team took only 4 to 6 weeks to complete the audit after receipt of certified accounts alongwith statutory auditor's report. The DAI also clarified that for all Navratna Companies and listed PSUs, comments under Section 619(4) of the Companies Act for the year 2003-04 were issued well in time to hold AGM by the stipulated date. Similarly, for quarterly financial results (QFR) in case of listed companies, the companies can avail of the services of the statutory auditors appointed by C&AG who would be available by the first QFR or company can engage any Chartered Accountant firm other than statutory auditors as per instructions of SEBI.



He also mentioned in this context, the bigger malaise of delay in closing of accounts by companies and gave data of companies that had not sent their accounts to C&AG for audit by 30 September 2004 (in case of 2003–04 Accounts). Also companies that had not prepared accounts for years.

The C&AG viewed the Report of the Committee very objectively and positively. He responded very positively to some of the suggestions and recommendations of the Committee. As a result of these, some follow up action was taken regarding prescribing materiality criteria in the selection of Companies for annual accounts audit of Central/ State Government Companies.

It will be interesting to recall here that in 1984, Dr. Arjun Sen Gupta, who was then Special Secretary to the Prime Minister headed a Committee to Review Policy for Public Enterprises. The Committee in its Report of 31 December 1984 dealt with the role of Comptroller and Auditor General of India in the audit of Public Enterprises. The two questions that engaged the attention of the Committee were:

- (i) Performance audit of PSUs done by C&AG
- (ii) Supplementary audit of PSUs [under section 619(4)]

On Performance Audit, the Report had this to say 'The general consensus in the Committee is that performance audit of the Auditor General should be continued. These reports serve a very useful purpose and have generally earned the respect and admiration of the legislator and the discerning public.'<sup>22</sup>

On Supplementary Audit, the Committee said 'It is ... a moot point whether supplementary audit on the annual accounts of Public Enterprises should continue. In the view of Chief Executives of PSEs the additional certificate presently given by the C&AG in the case of Public Enterprises was superfluous. The Committee then went on to analyze the issue by dividing the PSUs into 2 segments—profitable non-core companies and large enterprises in the core sector. For the former, it recommended doing away with C&AG audit; for the latter it said 'Supplementary Audit, as at present may be continued'<sup>23</sup>.

It also suggested that in large core sector enterprises, it was necessary to avoid two audits 'regular audit by Chartered Accountants may be dispensed with and only audit by C&AG provided for by suitable amendment to Act'.

## CORPORATE GOVERNANCE

Corporate governance issues became subjects of focused attention, following the disclosure of a number of corporate scandals involving some of the reputed companies like ENRON, World Com, etc. These developments forced the Government towards bringing in some legislation to enforce corporate integrity, accountability and better governance. In USA, SARBANES OXLEY Act was enacted for the purpose in 2002. In India, corporate governance practices were introduced through amendments to Companies Act in 2000. SEBI also introduced a new clause 49 in listing agreements between Stock Exchanges and the Companies listed. These changes were mostly the outcome of three important Committees viz, Kumarmanglam Birla Committee appointed by SEBI in 1999, Naresh Chandra Committee appointed by Ministry of Finance in 2002 and Narayana Murthy Committee, appointed by SEBI in 2003. The important aspects of good corporate governance introduced through clause 49 of Listing Agreement or amendments to Companies Act 1956, were independence of auditors, audit committees, independent Directors on the Board, Chief Executive Officer's certification of financial statements, Director's Responsibility Statement and transparent disclosures. Also Board of Directors should have not less than 50 percent as non-executive Directors in the case of listed companies.

Audit saw its role very clearly in Corporate Governance issues. A quality audit itself is a great contributory factor in Corporate Governance.

C&AG became active in seeking the compliance of Corporate Governance requirements from listed Government Companies, and, therefore, in the Audit Report (Commercial) for the year ended March 2001 (No.1 of 2002), a picture of the compliance of these requirements was presented. The review revealed that a number of companies, though listed, had not fulfilled the requirement of having minimum 50 per cent independent Directors in the Board excluding Government nominee Directors, Government Directors were not regular in their attendance on the Board's meetings indicating their weak commitment towards principles of corporate governance and while BHEL had a Board level Audit Committee from July 1998 which was reconstituted in August 2000 in line with amended Companies Act, but Audit Committee vacancies were not filled in so that Annual Financial Statement of the company for the year 2000-01 could not be reviewed by them. In some of the

big companies, Audit Committees were not mandated to look into fraud and fraud related risks.

The present C&AG took a keen interest in corporate governance issues. In a letter to Cabinet Secretary, B.K. Chaturvedi, he made a suggestion, in March 2005, for a need to evolve a Code of Corporate Governance specifically for Public Sector Enterprises. He said such a code would be able 'to highlight issues unique to the Public Sector Enterprises in India'. He said such a move would also have a 'salutary impact on business ethics in Public Sector'. Based on C&AG's advice, guidelines for Corporate Governance have been issued by the DPE for all public sector enterprises under the Union Government in June 2007.

In an important decision, C&AG directed (in July 2006) that a data base on listed and other major Central and State PSUs be prepared to include the information on mandatory practices relating to corporate governance under clause 49 of SEBI Act and under the Companies Act. The data base is quite comprehensive, and will be used by the C&AG to project in his Audit Reports the status of Corporate Governance in PSUs.

In a comprehensive survey of the status of corporate governance requirements in 45 listed Government companies, the results of which were reported in Audit Report No. 9 of 2007, the C&AG made following important observations<sup>24</sup>:

'Though most of the companies had generally complied with the requirements of Corporate Governance in a constructive manner, the main non-compliance observed related to absence of required number of independent Directors on the Audit Committee. In 12 government companies, there was no independent Director on the Audit Committee and in five government companies the Audit Committee did not comprise the required number of independent Directors. This resulted in a number of other related instances of non compliance with clause 49'.

C&AG also directed that of the 10 Best Practices for Audit Committees included in the Blue Ribbon Committee Report<sup>25</sup> on improving the effectiveness of Corporate Audit Committees, the following 4 may be included for C&AG's directions to Statutory Auditors under section 619(3):

- (i) The external auditors to report annually on their independence from the company.
- (ii) The audit committee to discuss the quality of accounting principles with the external auditors.

- (iii) The audit committee to produce a report on its activities.
- (iv) Quarterly financial statements to undergo a critical review by the external auditors.

#### REGULATIONS-2007

The newly proclaimed Regulations have further streamlined the procedure for audit by statutory auditors. These include, inter alia, preparation of programme of audit by statutory auditor in consultation with the company and also the Member Audit Board. The Regulations have detailed the various duties and responsibilities of statutory auditor in planning his work. It has also listed out the responsibilities of statutory auditor vis-à-vis Principal Director of Audit (Commercial) and MAB.

*Audit Arrears Committee:* Regulations have also streamlined the system of settlement of outstanding audit observations which is a big issue at present. In case of both Central and State Public Sector Enterprises, the responsibility for settlement of Audit observations lies with the management of the company. Each Company, which has large number of IRs and paras outstanding for more than two years, shall constitute an 'Audit Arrears Committee' consisting of sufficiently senior officers of the Company for speedy settlement and clearance of outstanding Audit observations. The Government concerned will take steps to ensure constitution of these Committees and their effective functioning.

#### STATE COMMERCIAL AUDIT

State Accountants General carry out audit in three distinct functional groups namely:

- ❖ Civil Audit i.e. dealing with audit of all the State Government Departments and other allied institutions;
- ❖ Receipt Audit i.e. dealing with the Revenue receipts of the State Government; and
- ❖ Finally, Commercial Audit i.e. dealing with all commercial enterprises or State PSUs of the State Governments.

There is no uniform pattern about the charges held by State AGs in respect of these three functions—at some places Accountant General (Audit) deals with Civil Audit Report as well as Commercial Reports while another AG deals with Audit Report (Receipts) and at the other places one AG deals with Civil Audit while another deals with both, Commercial and Receipts. Only

Accountant General (Commercial Audit) Maharashtra, Mumbai holds exclusive commercial charge. For commercial audit, there is a separate cadre in respect of the Section Officers and above which is administratively controlled by the Commercial Audit Wing of Headquarters under the DAI (Comml.)-cum-Chairman Audit Board.

The audit process and system etc. in respect of audit of State PSUs is exactly same as in the case of Central PSUs. As Companies Act, 1956 applies to Government Companies across the country whether they are Central Government Companies or State Government Companies, the provisions relating to the audit of these companies in the Companies Act which defines the powers and functions of the C&AG as regards the audit of these companies is applicable to State PSUs also. In the case of Statutory Corporations set up under the State Act, even if there is a provision regarding the audit of that corporation by the C&AG, necessary procedure for entrustment of audit to the C&AG in terms of the C&AG's DPC Act will need to be followed.

The total number of State Government entities as on 31 March 2005 subject to C&AG's audit were 1233 comprising 1062 Government Companies; 92 statutory corporations, 15 State Electricity Regulatory Commissions and 64 deemed Government Companies. One peculiar feature of State Government Enterprises is that a number of them are not functional for example as on 31 March 2005, as many as 320 state government enterprises were non functional. Another disturbing feature is that a large number of them do not have their accounts up to date and the arrears in accounts vary from company to company, state to state but overall accounts of around 775 companies were in arrears for a period ranging from one year to 35 years. A large majority of these undertakings are running in losses.

Fifteen<sup>26</sup> State Accountants General produce an exclusive Audit Report on Commercial Audit for C&AG's countersignature and presentation to Legislature. Audit Report on commercial entities in respect of Himachal Pradesh was issued in some years as a combined Civil and Commercial Report and as an exclusive report in some years depending upon the coverage and materiality of the audit findings. In respect of all other states namely Arunachal Pradesh, Chhattisgarh, Delhi, Goa, Jammu and Kashmir, Jharkhand, Manipur, Meghalaya, Mizoram, Nagaland, Puducherry, Sikkim, Tripura, Commercial chapter is included in the Audit Report (Civil) of the concerned states. These reports are discussed in the

Committee on Public Undertaking of the State Legislature. The status of discussion of State Commercial Audit Reports by COPU is reflected in the Annex.

At Headquarters, an Addl. DAI heads the State Commercial Reports Wing, some of the important developments that occurred in the post 1990s in this field are recounted below:

- ❖ C&AG constituted an Audit Review Committee for Comprehensive Appraisals of Public Sector Enterprises (ARCPSE) in the State for which a letter was addressed to all the Accountants General in charge of State Commercial Audit in September 2002. This Committee essentially is some kind of a replica of Audit Board mechanism prevalent for the Central Public Sector Enterprises. As far as State Public Sector Enterprises were concerned, no procedure existed for any discussion on the draft audit appraisal or interaction with State administration or the Chief Executive. Some States PAG/AG held power point presentations on the draft comprehensive appraisals/reviews followed by discussion with the Secretaries and the Chief Executive of the organization and from these interactions, the perception gathered was that such an involvement of the auditee companies/State Government secretaries would be highly useful and rewarding for a number of reasons. As a result, C&AG formally decided to constitute a State level committee styled as above on a regular basis. The Committee has six members including the member secretary who will be the group officer in charge of Commercial Audit. The Committee headed by AG in charge of the audit appraisal and AG holding Commercial charge of a neighbouring state were to be another expert member. Government nominees included Secretary of the respective department, and CMD/MD of Company/Cooperation concerned. In case technical issues were involved, State Government could nominate a technically qualified person to be a technical member. It was also provided that DAI/ADAI State Commercial, if he so desired, could nominate an officer from Headquarters to attend the meeting of the Committee. The Committee basically was to be a forum for inputs for the suggested appraisal. The instructions had made it clear that committee would only go into merits and demerits of the points or audit findings and if the management/government disagreed with any audit point they would convey the same in writing in reply to audit queries

raised or draft appraisal issued. This will be considered and incorporated with suitable remarks in the final appraisal report. AsG were requested to bring to the notice of the State Government the formation of ARCPSE so that they could issue necessary instructions to the departmental head and Chief Executives of companies. These Committees have been formed in most of the states but the interaction level differs from State to State. However, overall these committees have facilitated in the performance audit of the State PSUs.

- ❖ A five year rolling corporate plan for State Commercial Wing was introduced from the year 2000–01.
- ❖ The IT Audit plan was introduced in the Commercial Audit Wing of States from 2002–03. Now, State Audit Reports on Commercial audit include IT Audit findings.
- ❖ Perspective Plan 2003–08 of the department was also applicable for State Commercial offices.

Several new themes/ topics were introduced for study, analysis and inclusion by the AG in their Audit Report (Commercial) as indicated below:

- (a) Analysis of internal control system in the State PSUs;
- (b) Corporate Governance in the State PSUs;
- (c) Persistent non-compliance with Accounting Standards;
- (d) Compliance with environmental laws;
- (e) Arrears in accounts;
- (f) Analysis of reasons for loss making companies; and
- (g) Theft of energy and material in State Electricity Utilities.

Following the introduction of new Performance Auditing Guidelines, the format of Performance Reviews was revised by Headquarters in July 2005.

A system of Audit Committees for settlement of old Inspection Report paragraphs was introduced in April 2003.

#### RANKING PERFORMANCE OF COMMERCIAL AUDIT OFFICES

In another notable development during this period a system for ranking of Offices was introduced by Headquarters in 2004. This applies to all the branches of C&AG and is not peculiar to Commercial Audit Branch. After implementation of the system for ranking of offices for the year 2004–2005, some skewedness in the system was observed and accordingly modifications were made

by Central Commercial Wing for ranking performance of offices under its purview. An attempt has been made for the first time in the department to rank the performance of the Audit Offices in an open and transparent manner, the department is perfecting the matrix further to get as appropriate ranking as possible.

#### MEASURES FOR IMPROVING THE EFFECTIVENESS OF AUDIT OF COST ACCOUNTS/RECORDS OF PUBLIC SECTOR UNDERTAKINGS

Realizing that the effectiveness of the prevailing audit of cost accounts/cost records of PSUs was not much even though cost control and cost reduction had become significant factors for their survival, the Headquarters issued instructions in May 2005 in this regard for compliance by field offices. These instructions were based on the recommendations of a Committee appointed by C&AG and as approved by him subsequently:

- ❖ The instructions required each PDCA/AG to review the functioning of PSUs within his/her charge and if it was felt that costing in a particular unit/area of activity of a PSU required special attention, a special group/team was to be created by drawing qualified officers from other assignments.
- ❖ Regular refresher courses for officers/staff working in Commercial Audit offices were to be organized in consultation with RTIs for training in understanding costing information and cost accounts as also critical examination/audit thereof; a special course on capital budgeting techniques was also to be organized jointly for all the offices in the area.
- ❖ Commercial Audit staff having professional qualifications like CA/ICWA were to be utilized to their full potential by giving them proper assignments keeping in view their qualifications and requirements of the office.

The instructions also enclosed a list of model checks to be exercised during the audit of cost accounts of PSUs for reference and guidance of the officers.

The existing title sheet for supplementary audit of accounts as prescribed in the 'Handbook of Instructions' was reviewed and revised in March 2007 to include the standard audit checks. The revised 'Title Sheet for Comments on Accounts' is applicable for the reporting cycle 2007-08.

A few important paragraphs pertaining to Commercial Audit are discussed below:



*ONGC Joint Venture:* The production sharing contracts for development of certain oil fields as joint venture between the National Oil Companies (40% stake) and certain private operators (60% stake) were approved by the Ministry of Petroleum and Natural Gas without submitting to the Government, the comparative economics of these oil fields being developed by National Oil Companies on a stand alone basis. The estimated oil reserves which formed the basis of evaluating different qualifying bids were not only the lowest of a set of varying estimates projected at different stages leading to contract being awarded but also differed from the estimates mentioned in the notice inviting tenders. The bid evaluation criteria mentioned in the notice inviting bids were not complete and unambiguous and the whole procedure of tender evaluation suffered from various inadequacies. In awarding production sharing contracts in respect of Panna-Mukta and Mid & South Tapti Oil fields past cost compensation amounting to Rs. 676.52 crore was not insisted upon. Similarly signatures/ production bonus payable by the Joint Venture to ONGC/OIL were not based on well defined rationale. The contracts were also indicative of lack of level playing field for the National Oil Companies vis-à-vis Joint Venture operators in matters of pricing, royalty, cess and customs duty. No. detailed abandonment procedures were incorporated in the contract.

(Report No. 5 of 1996)

*Steel Authority of India Limited (SAIL):* In 1999, C&AG brought out a Report on the four areas of working of SAIL. These were; (1) Modernisation of Rourkela Steel Plant; (2) Marketing Organisation of SAIL; (3) Import of Coking coal by SAIL; and , (4) Utilisation of Aircrafts owned by SAIL. This was not a full fledged comprehensive review of the company as such and in that sense 'the Report was not a complete chronicle on the working of SAIL', but the report projected some very vital but weak areas of functioning of SAIL. This Review was more in line with the then prevailing system of bringing out Mini-Reviews on certain aspects of a company's working.

The first Review on Modernisation of Rourkela Steel Plant brought out that despite huge investment of Rs. 2461 crore on modernisation, it mostly turned out to be unproductive since there was little or no improvement in techno-economic parameters and these plants continued to incur progressively huge losses. A part of these losses were attributable to SAIL's late reaction to the

changed market scenario. In the case of modernisation, the actual results were very poor compared to what was estimated. While it was envisaged that hot metal production would go upto two million tonne (MT), it could produce only 1.4 MT of hot metal during the years 1997–97 and 1997–98. Similarly, the crude steel production was 1.1 MT before modernisation while after modernisation the actual production was about 1.2 MT which was less than the base capacity level of 1.4 MT before modernisation.

In the review of Marketing Organisation of SAIL, the report brought out the dismal performance of its marketing policy. Among the inefficiencies noted by Audit were failure of the company to formulate its new marketing policy in time to face the challenge of decontrol of the steel sector, failure of the company to regulate the production with the market demand even after making huge investments on plants modernization—the private sector snatched the initiative from them; and the substantial variation in actual production of iron and steel material vis-à-vis the companies sales planning and finally Audit Report also brought out an interesting factor that while the marketing organisation of company was located at Calcutta, its Director was based in New Delhi. Audit criticised the pricing policy of the company on various accounts and brought out that company could not fulfil its target of sales in any of the year from 1992–93 to 1997–98 except in 1994–95. The company was saddled with a very sizeable stock of saleable steel lying in the stockyards for a period of more than six months and on the sundry debtors front, it was again a very dismal picture—the total debts of the company increased from Rs. 913 crore in 1993 to Rs. 1932 crore in 1998.

In its review of Import of Coking coal by SAIL, audit report brought out the adhocism involved in purchase of an important raw material which constituted the significant percentage of total inputs. The coking coal was imported to meet the gap between the indigenous availability and actual requirement and also for improving technical parameters of coal blend. The Report indicated that company changed technical specifications of coal ten times upto year 1991 and these were further broad based in 1995. These changes caused losses to the company as reflected in the Audit Report. SAIL also lost or incurred extra expenditure on import of coal on spot purchases between 1992 and 1995. SAIL also was a looser on long term contracts concluded with Japanese Steel Mill and incurred additional expenditure on these long term contracts and finally, the Report brought out that in violation of Government's

instructions, SAIL allowed the foreign suppliers to engage Indian agents and paid agency commission to them.

Fourth subject of review was 'Utilisation of Aircraft owned by SAIL'. SAIL had a fleet of six aircrafts of which one crashed in February 1998. Various points brought out by audit on this subject were: the percentage of non-entitled passengers to total passengers for five year period 1992-93 to 1997-98 was between 34.82 and 56.36; exclusive flights for spouses and dependents numbered 33 which was a violation of guidelines issued by SAIL; there was no rule for taking approval from the next higher authority in case of use of the aircraft by the spouses or the dependents of the competent authority. Audit also noted that journeys of 34 passengers who were spouses/dependents of Managing Directors/Director were treated as official. There were several comments in the Audit Report about the irregularities like non maintenance of passenger lists, non availability of information relating to entitled/non-entitled passengers, maintenance of journey log book without indicating the status and entitlement of the passengers who used the aircraft etc. Audit also noted violation of air-safety regulations by the aircraft. It was also brought out that the aircraft were grossly underutilize—the utilization of the aircraft to the available hours ranged between 1.49 per cent and 40.6 per cent during 1992-93 to 1997-98 because of many empty flights. The incidence of extra expenditure due to excess consumption of fuel was to the extent of Rs. 81.46 lakh.

(Report No. 6 of 1999)

*Extra Expenditure in Construction of Kishenpur-Moga Transmission System: Additional Expenditure of Rs. 433.81 Crore:* Audit Report (Commercial) of 2004 highlighted the case of huge extra expenditure by Power Grid Corporation of India Ltd. in the construction of Kishnepur-Moga Transmission system (KMTS). The original approved cost of the project was Rs. 417.71 crore (in May 1993) and while Audit calculated the total cost of the project when commissioned in January 2001 at Rs. 847.91 crore resulting in overall cost overrun of Rs. 430.20 crore and time overrun of 34 months, the PAC in their report reckoned the initial cost of execution of Rs. 857.63 crore resulting in cost overrun of Rs. 439.92 crore which was slightly more than double the cost of original approved estimate. This extraordinary escalation in the cost was attributable to a number of factors of which the main reason was the absence of any technical scrutiny regarding design of towers by the

company at the pre qualification stage. The abnormal increase in the weight of tested towers was the main reason for failure in design. It came out from the Audit Report that whereas the company was not in favour of engaging M/S Cobra, which was the lowest bidder for both the lines of KMTS because of his lack of experience, the World Bank did not agree to the recommendations hence both the contracts were awarded to M/S Cobra. Lack of experience of the firm in the execution of project of 800 KV lines led to repeated failures in design and testing of towers which caused delay of 23 months and resultant increase in project cost by Rs. 217.22 crore. While the management and the ministry stated that no technical compromise was made in adopting qualifying requirements for selection of the firm and that the delay was not due to any inexperience of the firm but the actual failure of towers during testing and limited availability of test beds in India. The delay was also attributed to severe right of way problem in this particular case, the PAC blamed the unreasonable World Bank conditionalities/guidelines and lack of adequate initial technical scrutiny by the Power Grid at the initial evaluation stage as two main factors resulting in cost and time overrun. Due to lack of prudence in initial planning and estimation, the inability of Power Grid to take the World Bank into confidence on various issues also contributed very much to the cost and time overruns. Out of the total project cost escalation, surprisingly more than Rs. 300 crore related to interest during construction (IDC) alone against the approved project estimate of Rs. 2 crore on account of IDC. The PAC wanted the government to open up the matter of payment of IDC with the World Bank for a refund of the claim of IDC on the ground that the delay in completing the project could be attributed solely to the firm which was 'thrust upon the PGCIL to execute the project only at the behest of the World Bank'.

(Paragraph 15.3.1 of Audit Report No. 2 of 2004)

## ANNEX

POSITION OF DISCUSSION OF AUDIT REPORTS  
(COMMERCIAL)  
BY COPU AS ON 30 SEPTEMBER 2006

| State                               | Year upto which discussion of paras of<br>Audit Reports completed by COPU |
|-------------------------------------|---|
| Karnataka and Rajasthan             | 2002-03 (except 2000-01)  |
| Gujarat, Haryana and Madhya Pradesh | 2001-02   |
| Kerala                              | 2000-01 (except 1999-2000)  |
| Maharashtra                         | 2000-01   |
| West Bengal                         | 1999-2000   |
| Himachal Pradesh                    | 1998-99   |
| Punjab                              | 1996-97   |
| Tamil Nadu                          | 1994-95   |
| Orissa                              | 1993-94   |
| Andhra Pradesh                      | 1991-92   |
| Assam                               | 1988-89   |
| Uttar Pradesh                       | 1981-82   |
| Bihar                               | 1980-91   |

## NOTES: CHAPTER-7

- <sup>1</sup> Statement made by the C&AG of India at the meeting of the sub-committee on the 'Exchequer Control over Public Expenditure' held on the 13th December 1952 also page 360 of R.K. Chandrasekharan: The C&AG of India—an Analytical History
- <sup>2</sup> R.K. Chandrasekharan: The C&AG of India—An Analytical History.
- <sup>3</sup> Chairman was common to all the Audit Boards constituted for the purpose of appraisal of a PSU. Till December 1989 an Addl. DAI headed the Commercial Audit Wing in HQrs. From 1st January 1990 the post was upgraded to DAI level.
- <sup>4</sup> Madras in July 1972; Ranchi in August 1972; Dehradun in December 1972; Calcutta in January 1974; Hyderabad, New Delhi and Bhopal in March/ May 1978.
- <sup>5</sup> Out of these, 1062 were Government Companies, 64 deemed Government Companies and 107 were Statutory Corporations. Of these about 320 were non functional companies.
- <sup>6</sup> This represents equity of 277 PSUs
- <sup>7</sup> A.K. Awasthi
- <sup>8</sup> Govt. company is provided in Section 617 of the Companies Act while section 619 B lays down the criteria for determining if a company is a deemed Government company.
- <sup>9</sup> Receipt of applications 'on line' from CA firms for empanelment was introduced in the year 2005, for the biennial years 2005–06— the data of all CA firms i.e. firm details, member details and branch details etc. are also obtained directly from ICAI in soft copy.
- <sup>10</sup> The Committee of RBI that selects the auditor has a representative of C&AG also.
- <sup>11</sup> C&AG's Audit Report, Union Government (Commercial), No. 9 of 2007.
- <sup>12</sup> R.B. Sinha was the concerned Member, Audit Board; this point was discussed at length by the Chairman, SAIL (Arvind Pande) along with his top team with C&AG and author who was then DAI-cum-Chairman, Audit Board.
- <sup>13</sup> General Clarification (GC)—AASB/1/2002
- <sup>14</sup> Statement on Standard Auditing Practices has been renamed as Auditing and Assurance Standards and carry the same authority as attached to SAPs.
- <sup>15</sup> For an excellent account of Audit Board Mechanism and the views of important committees viz The Economic Administration Reforms Commission, chaired by Shri L.K Jha (1984) and Dr. Arjun Sen gupta Committee (constituted in September 1984 to review the policy for public enterprises), please see R.K. Chandrasekharan's History pages 527–534. The author has given his comments on the views of these two Committees concerning Performance Audit of Government enterprises including Audit Board Mechanism.
- <sup>16</sup> Note dated 18th March 2005 recorded by PD (Commercial)
- <sup>17</sup> Note recorded by Shri Sunil Chander, Pr. Director (Commercial Audit) to Member Secretary Audit Board
- <sup>18</sup> C&AG had recorded his note in March 2005.
- <sup>19</sup> The Committee was constituted vide DPE Notification No. 18(24)/2003-GM dated 11.11.2004 and was headed by Dr. Arjun Sengupta
- <sup>20</sup> Secretary, DPE's D.O. to C&AG forwarding the Report of the Group
- <sup>21</sup> Other Members of the Task Force were Addl. DAIs, Report-Central, Report-States, C&SCS, RA and DG (Audit) and DG (Performance Audit). PD (Commercial) as Member & Secretary.

- <sup>22</sup> Report of the Committee to Review Policy for Public Enterprises December 1984
- <sup>23</sup> As above
- <sup>24</sup> Chapter 3 of C&AG's Audit Report, Union Government (Commercial), No. 9 of 2007 (Regularity Audit)
- <sup>25</sup> Blue Ribbon Committee was constituted by the New York Stock Exchange and the National Association of Securities Dealers on improving the Effectiveness of Corporate Audit Committees. The Committee was actually created in response to the concerns expressed by Arthur Levitt (in September 1998) Chairman of SEC in address at New York University which mostly focused on issues involving quality of financial reporting.
- <sup>26</sup> Andhra Pradesh, Assam, Bihar, Gujarat, Haryana, Karnataka, Kerala, Madhya Pradesh, Maharashtra, Orissa, Punjab, Rajasthan, Tamil Nadu, Uttar Pradesh, and West Bengal.

## LIST OF KEY EVENTS

|                  |  |
|------------------|--|
| September 1990   | Headquarters issued instructions regarding system improvement in the Commercial Audit Wing   |
| 1993             | Introduction of computerized database of applicants for registration for preparing panel of statutory auditors for companies.  |
| January 1994     | C&AG received communication from Banking Division for dealing with recommendations of JPC Report on Irregularities in Securities and Banking Transactions  |
| 1999             | Section 210 A was inserted in Companies Act empowering Central Government to constitute National Advisory Committee on Accounting Standards having a representative of C&AG.   |
| December 2000    | Companies Act was amended with provision that the appointments of Chartered Accountants will be made by C&AG.  |
| July 2001        | Issue of instructions containing checks to be exercised by field audit parties to avoid manipulation of accounts.  |
| 4 September 2002 | C&AG approved constitution of audit review committee for comprehensive Appraisals of State Public Sector Enterprises (ARCPSE)  |
| 5 September 2002 | Time limit of six weeks laid down for completion of annual accounts of PSUs  |
| 30 May 2005      | Instructions issued regarding finalization of comprehensive appraisals through the mechanism of Audit Board. These contained measures for improvement of the system. This was followed by another circular issued on 7.11.2005 |
| 2 December 2005  | C&AG wrote to Prime Minister countering opinion of Irani Committee that supplementary audit of Government Companies was superfluous.   |
| 20 January 2006  | Constitution of permanent 'Audit Board for Central PSUs'   |
| 20 June 2006     | Common parameters for evaluation of risk analysis for different types of audit developed in Headquarters were communicated to all MABs and DG(P&T).  |
| 21 July 2006     | Revision of criteria for selection of Government Companies for audit of their accounts under section 619(4) of Companies Act 2006  |
| 2 August 2006    | The system of issue of 'Review of Accounts' in respect of Central Government Companies was dispensed with.   |
| 5 March 2007     | Revision of format for issue of comments under section 619(4) of the Companies Act.  |
| 14 March 2007    | Headquarters issued instructions regarding improvement in financial reporting.   |
| 14 March 2007    | Revision of Title Sheet for Comments on Accounts of Central PSUs   |



|              |   |
|--------------|---|
| May 2007     | C&AG nominated DG (Commercial) as his nominee on the Quality Review Board.  |
| 20 June 2007 | Circular issued for determining the significance/materiality for C&AG's comments under Section 619(4) of Companies Act. |

## DOCUMENTS

## 1

Statement made by the Comptroller and Auditor General of India at the meeting of the sub-Committee on the 'Exchequer Control over Public Expenditure' held on the 13 December, 1952.

14. In considering the setting up of a suitable machinery for Exchequer control, it will not be irrelevant to mention certain recent developments which have the effect of whittling away Parliamentary control over public monies. I refer to the formation of Private Companies under the Indian Companies Act for management of Governmental Industrial Undertakings financed from the Consolidated Fund. These 'Private Ltd.', Companies are, in my opinion, a fraud on the Companies Act and also on the Constitution, because money cannot be taken away from the Consolidated Fund for the establishment and transformation of certain concerns into Private Companies in the name of the President and Secretary to Government. Under the Companies Act, a Company can be formed by a group of persons. The President or the Secretary to Government is not a person. These officers do not have any personal financial interest in the Company and their joining together cannot constitute a Company in the correct sense of the term. Further, to convert a Government concern into a Private Company solely by executive action is unconstitutional. While recognizing that the management of industrial and business concerns differs from normal day to day activities of administration and that special organization and delegation of authority more in accordance with the speedier business practices may be necessary, the Government should have the backing of suitable Parliamentary enactment for the setting up of Corporations.

There is another important point involved in this procedure of creating a Private Company under the Indian Companies Act, Private Companies are to be audited by Auditors nominated by the Board of Directors. The Comptroller and Auditor General will not, therefore, have any automatic right to audit such a Company. It is likely to be argued that his audit control is thus ousted. It is true that the Company may request him to be the Auditor if necessary by incorporating suitable provisions in its Articles of Association, but this would be neither proper nor binding as the Comptroller and Auditor General's duties and functions are prescribed by Parliament, and cannot be regulated by the Articles of Association of a Company. Furthermore, even if he undertakes audit on a 'consent' basis, on payment of fees, he can only submit his Audit Report to the Company, and not to Parliament through the President. Parliament cannot watch through the Public Accounts Committee the regularity of the operations and the financial results of any such Company. These observations also apply to concerns in the form of Private Companies in which Government take substantial share capital or guarantee against losses.

I regard the entire procedure adopted in these cases as unconstitutional and invalid, and hold that I have a right to exercise audit on the accounts of the Company on the basis that by an improper diversion of funds they should not escape my audit scrutiny. I may mention that the creation of such Companies

through executive action is expressly prohibited in the U.S.A., and the Congress has specifically to legislate in the matter.

Authority: Appendix I to the Public Accounts Committee's Third Report 1952-53

## 2

D.O No. 221-CAIV/94-98 date 25 July 200 from Pr. Director (Commercial) to all MsAB, DG (P&T) and PD (Central Railways)

Dear

While examining the comments on the accounts of Government Companies/Corporations, it has been observed that a number of PSUs are window dressing their accounts for showing better results. The possible ways by which the companies can manipulate their profits are:

- ❖ Wrong setting of sales or accounting of income on services rendered at the time of closing of accounts;
- ❖ Manipulation in valuation of the closing stock of inventories;
- ❖ Unrealistic account of interest income, the principal amount of which is doubtful of recovery;
- ❖ Some time expenditure is accounted for less or more to manipulate the profit/loss. For example providing less or more depreciation, providing less or more for statutory dues, doubtful debts/loans & advances/investments, and other liabilities;
- ❖ Sometimes specific liabilities are shown as contingent liabilities;
- ❖ Making a provision and then writing it back in subsequent year;
- ❖ Accounting Policies are changed frequently for showing better results;
- ❖ Manipulation in accounting various claims;
- ❖ Instead of providing for known liabilities or income, a brief disclosure is given in the notes to accounts;
- ❖ Non-registration of title deeds of property and also not providing for liability on account of expected stamp duty payable on registration of title deeds;
- ❖ Absence of clear title on property.
- ❖ Prior period adjustments;
- ❖ Sale/purchase of securities /investments;
- ❖ Depreciation amortization and depletion in the case of Oil & Gas accounting;
- ❖ Other Sector specific ways within the knowledge of MABs.

DAI (C) had directed that in addition to normal checks being exercised in the accounts audit, the areas where possibility of window dressing is more may be critically examined by the field audit parties during accounts audit and suitably commented upon so that the accounts represent a true and fair view of the affairs of the company. He has further desired that to ensure due diligence in examination of these issues a statement indicating in brief the results of examination of these items (mentioning comments proposed in each category)

may invariably be prepared and sent to Headquarters along with the proposal for approval of comments or 'nil' comments.

The issue regarding sending of aid-memoire in respect of draft comments dropped by MAB has been examined and it has been decided that aid-memoire may only be sent in respect of draft comments proposed for approval. In respect of draft comments dropped by MAB or his Group officer, a summary of the dropped comments in the enclosed proforma may be sent along with the proposal for approval of comments or 'nil' comments.

3

No. 376 CA-IV/83-2004

Date: 7-11-2005

To,  
All MsAB  
DG(P&T)

Sub.: Changes in the Audit Boards Mechanism for Central PSUs.

Sir/Madam,

The system of appraising the working of central PSUs through the mechanism of the Audit Board was introduced w.e.f 1 April 1969 by formation of Audit Boards under the jurisdiction and control of the C&AG as part of this organization for conducting comprehensive appraisal on the working of commercial undertakings of Central Government. The system worked well when the size and geographical spread of the PSU was within manageable limits and the performance of PSUs needed close monitoring because of their inherent weaknesses. However, over the years, there have been drastic changes in the operating environment of PSUs and the monitoring mechanism of PSUs in government has also been strengthened. With the increase in the size of the companies and the vast diversification in their scope of activities, the conduct of comprehensive appraisals on all aspects of their working is perhaps not necessary. Accordingly, it was felt that there is a need to effect changes in the approach of audit from conducting comprehensive appraisals of PSUs to focusing on critical areas of concern in their performance for which orders have already been issued vide letter no. 185-CA-IV/83-2004 dated 30 May 2005. The Audit Board will now focus its attention on Performance Audits of thematic issues. These issue may relate to a particular PSU or could cut horizontally across several PSUs. The objective of such a well-designed study would be to provide a clear sense of direction and focus to the audit effort, provide a logical framework, which will add value to the organization from the likely findings and recommendations, and reduce staff time wasted on irrelevant collection and analysis of data. Such an approach will make the audit findings more relevant for management decision making and will be in tune with the increasing emphasis being laid on performance audits.

2. It has, therefore, been decided, in consultation with the Department of Public Enterprises, to restructure the Audit Board to make it more dynamic and responsive to changing time, while at the same time retaining its useful aspects. The benefit of expertise of technical members (i.e. part-time members)

is proposed to be retained, but in order to reduce delays arising on account of their appointments and difficulties in holding meetings of the Audit Board on account of non-availability of part-time members for one reason or another, instead of two part time technical members (nominated by the Government on the advice of the CAG), they will be co-opted as 'special invitees' depending on the sector of operation of the PSU.

The Audit Board will now be designated as 'Audit Board For Central PSUs'. The structure & composition and duties & powers of the Board will be as under:

*I Structure and Composition of the Board:* The Board will be a permanent body as against the existing temporary nature of the Audit Board (being formed for each appraisal) and will consist of the following:-

1. Dy. Comptroller & Auditor General (Commercial)—Chairman
2. Director General (Performance Audit)—Member
3. Two Principal Directors of Commercial Audit on rotation basis for one year—Members
4. Economic Adviser—Member
5. Pr. Director (Commercial) as Member Secretary.
6. Pr. Director conducting the performance audit (as special invitee)
7. Special invitees—1 or 2 technical experts in the field.

Technical experts will be co-opted as special invitees, if necessary, instead of as part-time members from a panel of experts to be prepared and maintained (reviewed/revised every year) by this office for each sector and appointed by the concerned administrative Ministry in consultation and concurrence with this Department. The special invitees will have the same status as that of members of the Audit Board for Central PSUs. The nomination of 2 Pr. Director of Commercial Audit & Ex-officio Member Audit Board on rotation basis for one year (without renewal) will be made with the approval of CAG.

The orders for constitution of the Audit Board for Central PSUs will be issued by this office and the Board will function as an internal mechanism for conduct of all Performance Audits of Central PSUs as per Performance Audit Guidelines.

*II Duties and Powers of the Board:* The Board will examine the selection of topics based on strategic audit plan. It will examine the detailed justification for taking up the critical topics and critical issues to be focused therein. All the topics for Performance Audit will be selected by the Board. The Board will recommend whether performance audit will be taken up as a stand-alone report or for inclusion in Commercial Audit Reports No. 8 & 9. The Audit Board will focus on thematic issues, rather than the holistic approach of a Comprehensive Appraisal as per instructions conveyed vide HQrs. letter No. 185-CA-IV/83-2004 dated 30 May 2005.

The 'Audit Board for Central PSUs' will conduct Performance Audit under 2 categories:

*Category I:* Only the topics will be selected by the Board. Subsequent processing of performance audits will be carried out as per performance audit guidelines

by the concerned Principal Director of Commercial Audit as per time schedule laid down vide this office letter No. 185-CA-IV/83-2004 dated 30<sup>th</sup> May 2005. A representative of Headquarters may participate in the entry/exit conference with the management. These Performance Audits will be included in Commercial Audit Report new series No. 8 & 9 and will follow a 12 month cycle from one Audit Report to the next.

*Category II:* This will consist of those topics, which are selected for being brought out as 'stand alone' reports due to the extensive and significant nature of the issues involved. All Performance Audits under this category will follow 18 month cycle as laid down in Hqrs. letter No. 185-CA-IV/83-2004 dated 30<sup>th</sup> May 2005. After the 1<sup>st</sup> meeting for selection of topic by the Board, as above, subsequent follow up will also be made by the Audit Board in meetings to be held as under:

2<sup>nd</sup> meeting: to approve the guidelines, audit objectives, criteria and methodology for conducting audit

3<sup>rd</sup> meeting: for finalization of audit report, with representatives of Ministry/ Management, who may be invited for the purpose. The special invitees will be nominated after the topics are selected in the first meeting of the Board.

- ❖ The Audit Board meetings will be conducted with available members and there will be no requirement of a quorum.
- ❖ The Board will be recommendatory in nature, and the selection of topics and performance audit reports finalized by it will be subject to approval of the competent authority.
- ❖ All performance audits to be undertaken for the Audit Reports of 2007 (work to be undertaken in 2006) will now be prepared under the jurisdiction of the new Audit Board right from the stage of selection of topics. All ongoing audit board performance audits will be processed outside the audit board system and finalized accordingly for Commercial audit report 8 & 9.

3. The IT audit reports will follow the IT Audit Guidelines and will be processed as per Hqrs. letter No. 238-CA-IV/101-2004 dated 10<sup>th</sup> August 2005. These will form part of Transaction Audit Report No. 12 as mentioned in Hqrs. letter No. 428 Rep(C)/18-92(Vol.II) dated 31 August 2005 from Director (RC). Hence IT audits will not be included within the scope of the Audit Board for Central PSUs as these are to be processed in consultation with iCISA, Noida.

4. The above instructions are issued for information and necessary action and they will be implemented w.e.f. their date of issue.

Yours faithfully,

Sd/-

(Sunil Chander)

Pr. Director (Commercial)

- Copy to :-
- (i) The Department of Public Enterprises with reference to their O.M. No. DPE/5 (20)/2005-Fin. Dated 18-10-2005.
  - (ii) All Members of Audit Board for Central PSUs.
  - (iii) All DAIs & ADAIs for information.

No. 35/CA IV/83-2004

Dated: 20 January 2006

Sub.: Constitution of permanent 'Audit Board for Central PSUs'. In pursuance of the instructions contained in this office circular No. 376-CA-IV/83-2004 dated 7 November 2005 circulated to all concerned regarding restructuring of the Audit Board, it has been decided to constitute a permanent 'Audit Board for Central PSUs' constituting of the following members:

1. Dy. Comptroller & Auditor General (Commercial)—Chairman
2. Director General (Performance Audit)-Member
3. Ms. Revathy Iyer, Pr. Director of Commercial Audit & Ex-officio, Member, Audit Board -II, Mumbai—Member (for one year)
4. Ms. Meera Swarup, Pr. Director of Commercial Audit & Ex-officio, Member, Audit Board-III, New Delhi—Member (for one year)
5. Economic Adviser—Member
6. Pr. Director (Commercial)—Member Secretary

The duties, powers and other details of functioning of the Audit Board for Central PSUs are contained in this office circular dated 7<sup>th</sup> November 2005 referred to above. The nomination of members on the Audit Board at S. No. 3 & 4 will be for a period of one year from the date of issue of this Office Order.

(Sunil Chander)

Pr. Director (Commercial) &  
Member Secretary, Audit Board

No. 405 CA-IV/11-98 DATE-21.7.06 from Director (Comml.) addressed to all MsAB and DGA (P&T), Delhi

Sub.: Criteria for selection of Government Companies for audit of their accounts under Section 619 (4) of the Companies Act, 1956.

Sir/Madam,

I am directed to invite a reference to this office Circular No. 41-CA-IV/11-98 dated 19 February 2004 on the subject cited above and to state that the existing criteria for selection of Government Companies for audit of their accounts under Section 619(4) of the Companies Act, 1956 has been reviewed and it has been decided to revise the criteria as under:

- I. Selection of companies other than finance companies:  
**Criteria:** Companies with either a paid up capital of Rs. 100 crore or more or a turnover of Rs. 250 crore or more should be selected for annual audit of accounts.

## II. Selection of finance companies:

**Criteria:** (a) Companies with paid up to Rs. 100 crore or more should be selected for annual audit.

(b) In addition MABs could select more such companies on the basis of risk assessment after reviewing the disbursement/ investment portfolio, poor internal controls and borrowings profile.

## III. Selection of finance companies not covered in the above criteria:

**Criteria:** Companies may be selected by MABs on the basis of criteria like risk assessment, expansion , internal control, huge market borrowings, loss making companies with accumulated losses of Rs. 100 crore etc.

## IV. Selection of all companies once in 4 years: All companies must invariably be audited once in 4 years to mitigate audit risk.

The above criteria may please be implemented with immediate effect.

## 6

No. 617 CA-IV/-22-2005 Date: 27-10-2006 from Director (Comml.) to all MABs and DGA (P&T)

Sub.: Issue of Management Letter to companies in case of supplementary audit.

Sir/Madam,

The matter regarding issue of management letter to companies with a view to bringing to their notice all matters that were not considered material enough for reporting in C&AG's supplementary audit observations, has been examined at Hqrs. It has been decided that issue of such letters to the management may be made a standard practice. Such matters could involve significant accounting and disclosure issues (including complex or unusual transactions and highly judgmental areas permitting alternative accounting treatment), which pose a credible risk to fair reporting in the Annual Financial Statements. It is, therefore, requested that in case of companies chosen for supplementary audit, Management Letters containing an exhaustive list of all important matters which have not been highlighted by statutory auditors and which were not considered material for C&AG's formal supplementary audit comment, may be issued to companies under your audit jurisdiction.

2. A copy of the Management Letter, as issued to companies, may also be sent to the statutory auditors seeking their clarification for not pointing out the same either in their formal Audit Report under AAS-28 or in their letter to the Audit Committee/Board under AAS-27.



7

No. 113 CA-IV/38-2006 dated 5.3.07 from DG (Comml.) to all MsAB and DGA (P&T), Delhi

Sub.: Revision of Format of issue of Comments under Section 619(4) of the Companies Act, 1956.

Sir/Madam,

The existing formats for issue of Comments under Section 619(4) of the Companies Act, 1956 by the C&AG have been reviewed in the light of national and international standards on reporting by the auditors. It is the accepted best practice that the assurance process of financial statements of an entity should clearly indicate its objective, scope and legal requirement. Keeping all these aspects in view, it has been decided under the orders of the C&AG to revise the existing formats of C&AG's comments under Section 619(4) of the Companies Act, 1956 and a copy of the following revised formats are enclosed:-

- (i) Revised Format for issue of 'Comments'
- (ii) Revised Format for issue of 'Nil' Comments.
- (iii) Revised Format for issue on 'Non-Review Certificate'
- (iv) Revised Format for issue of 'Nil comments after Revision of Accounts'
- (v) Revised Format for issue of 'Comments after Revision of Accounts'

*The above revised formats of Comments may be adopted in the Audit Reporting Cycle 2007-08.*

2. It has also been decided to obtain a 'Compliance Certificate' from the statutory auditors along with their Audit Report under Section 619(3) (a) of the Companies Act, 1956 in order to obtain an assurance regarding compliance with the C&AG's directions issued under the above mentioned Section. All MsAB/DGA (P&T) are, therefore, requested to ask the statutory auditors of the companies at the time of issuing directions/sub-directions to submit this Compliance Certificate along with their Audit Report under section 619(3) (a) of the Companies Act, 1956. A format of 'Compliance Certificate' is enclosed.

8

No. 153 CA-IV/4-98/Vol. II dated 14.03.07 from DG (Comml.) to all MsAB and DGA (P&T), Delhi

Sub.: Instructions regarding improvement in financial reporting by PSUs as a result of audit oversight by C&AG.

Sir/Madam,

The prime objective of C&AG's oversight role is to improve the quality of financial reporting by PSUs. It is therefore important to develop synergy with the Audit Committee of the PSU and the statutory auditor so that there is an overall improvement in financial reporting in the interest of better corporate governance. While reiterating the instructions contained in Circular No. 165/

CA-IV/4-98-Vol II dated 29 March 2006, following further instructions relating to the audit of accounts of PSUs may be kept in view by the field offices:-

- (i) In order to plan and conduct an effective audit, the audit party engaged in the audit of a particular PSU should acquire sufficient knowledge of the PSUs business risks to enable them to identify the events, transactions and practices that may have significant impact on financial reporting. A useful approach could be to maintain a Risk Register for each major PSU. This would help in identifying areas of special audit attention, to evaluate the reasonableness of accounting estimates and to make judgment regarding the appropriateness of accounting policies, accounting treatment of specific transactions and disclosures. The MABs/DGA (P&T) may please ensure this aspect while planning the audit and deputing audit teams.
- (ii) The significant accounting policies and notes to accounts disclosed in the financial statements should be relevant, comparable and understandable. It has been observed that some PSUs give extensive disclosures through accounting policies and Notes to Accounts. In such cases, the MAB/DGA (P&T) should review and discuss the same with the statutory auditors/management during the audit planning interactions to examine their relevance and necessity and possibility of eliminating the redundant, insignificant and irrelevant Accounting policies and Notes to Accounts. It may be kept in mind that some items under Notes to Accounts could be construed as camouflaged qualifications. At the same time, important information regarding extent of compliance with Accounting Standards off Balance Sheet items and important accounting policies (refer AS-1) may not have been suitably disclosed.
- (iii) In case of reiterated audit comments of statutory auditors/C&AG which involve interpretation of accounting policies/accounting standards and there is perceived ambiguity in interpretation of the same by the management/statutory auditors, these should be discussed with the management/statutory auditors in order to resolve the issue to the extent possible. In interpretation, the overall philosophy of substance over form should be given due consideration. If considered necessary the matter may be referred for the opinion of Expert Advisory Committee either by the PSU or by MAB/DGA (P&T).
- (iv) Where the audit is conducted in a computerized environment, the statutory auditors capability to conduct the audit in such environment in compliance with AAS 29 may be judged at the time of determining the scope and extent of C&AG audit and if required an official with IT Audit expertise may be included as a member of the audit team while conducting supplementary audit. This is vital as separate IT Audits should not reveal flaws in the financial reporting process.
- (v) Only material and significant comments may be considered for issue to the management. The general parameters for determining the

materiality both the amount (quantity) and nature (quality) are being developed at Hqrs. And would be issued shortly for the guidance of field offices. These may be kept in view while forwarding the draft comments to Hqrs.

- (vi) In so far as possible, lead MAB for the corporate entity should ensure that the audit approach and the sub-directions issued to statutory auditors from his/her office and those from the office of the MABs doing the branch audit are consistent. MABs should also try to ensure consistency in the audit approach and the sub-directions issued to statutory auditors of PSUs in the same industry/business sector. This is necessary to deter any criticism regarding whimsical or arbitrary approach to audit by our institution.
- (vii) The statutory auditors are required to review and assess the conclusions drawn from the audit evidence obtained during their audit as the basis for the expression of opinion on the financial statements of a PSU. The auditors' report should contain a clear written agreement or disagreement of accounting treatment of a particular transaction which is the subject matter of observations in audit report and it should not be ambiguous or require judgment on the part of the readers. Further, the audit report should also contain a clear and written expression of opinion on the financial statements taken as a whole. Any deviations in this regard may be discussed with the statutory auditors and if necessary, a suitable comment on the report of the statutory auditor proposed.
- (viii) Any minor observations on the auditors' report or the audit work of the statutory auditors which are not considered significant or material for C&AG's comments, should be communicated to the statutory auditor by the MAB/DGA (P&T). However, any serious lapse on the part of the statutory auditors that reflects poorly on his performance should be communicated through a show cause memo. These observations should be suitably reflected in the performance evaluation of the statutory auditor.
- (ix) MAB/DGA(P&T) while forwarding the draft comments to Hqrs. should clearly state the following:-
  - (a) whether he/she is proposing to issue any Management Letter to the PSU with a copy to statutory auditors as per instructions issued by this office in this regard
  - (b) whether he/she is proposing to issue a letter/memo to the statutory auditors as mentioned above.
  - (c) Whether the supplementary audit is conducted in accordance with audit procedures/checks envisaged in the Title Sheet prescribed for audit of accounts of PSUs (being issued shortly by Hqrs.)

2. Improvements in financial reporting brought about as a result of our audits should be consolidated and reported separately for possible inclusion in C&AG's Audit Report on 'Financial Reporting' for submission to the Parliament.

Instances of ambiguity in treatment under Accounting Standards, disparate financial reporting under the same business sector, disconnect between Government policies and PSU business practice, shortcomings or delays in regulatory action by the administrative Ministry/IRDA/BPE/SEBI/ICAI, etc. and other such matters likely to be of legislative interest/ concern may also be flagged and reported for possible inclusion in the same Audit Report. Successful initiatives taken up with the Expert Advisory Committee of ICAI may also be aggregated and reported.

## 9

No. 358 CA-IV/5-2006 dated 20.06.07 from Director General (Comml.) to all PDA and Ex-Officio Member Audit Board/ DGA (P&T)

Sub.: Circular for guidance of MsAB/DGA(P&T) in exercising their judgment in determining the significance/materiality for C&AG's comments.

Sir/Madam,

The matter regarding defining criteria to ensure that only significant/material comments are proposed u/s 619(4) of the Companies Act, 1956 has been examined in this office. It has been observed that materiality depends on the size and nature of an item judged in the particular circumstances of its misstatement and determining the significance/materiality of the comment is wholly a matter of the auditor's own professional judgment. However, in order to assist MsAB/DGA (P&T) in exercising their judgment, certain instructions, as contained in the enclosed Circular, are forwarded for their guidance.

### STRICTLY FOR DEPARTMENTAL USE CIRCULAR

The issue of defining the criteria for ensuring that only significant/material comments are proposed u/s 619(4) of the Companies Act, 1956 has been under deliberation for some time now. Attention is drawn to the Auditing and Assurance Standard 13 of the Institute of Chartered accountants of India, which states that materiality depends on the size and nature of an item, judged in the particular circumstances of its misstatement. While determining the significance/materiality of the comment is wholly a matter of the auditor's own professional judgment, the following guidance is intended only to assist Members Audit Board/Principal Directors of Commercial Audit/Director- General (P&T) in exercising their judgment.

The guidance has been divided in the following two parts:

- ❖ C&AG's comments on Financial Statements
- ❖ C&AG's comments on Statutory Auditor's report.

***C&AG's comments on Financial Statements:***

*1. Compliance with legal and regulatory requirements:* If the following legal or regulatory requirements applicable to the preparation and presentation of the financial statements have not been followed or complied with, the fact should, with reasons, if any, be commented upon.

(a) Requirements regarding form and contents of the financial statements as prescribed under the regulating Act like Section 211 of the Companies Act 1956 read with Schedule VI and Section 11(1)(a) of the Insurance Act, 1938 read with Schedule B to IRDA (Preparation of Financial Statements and Auditor's Report of Insurance Companies) Regulation, 2000.

(b) Compliance with prescribed Accounting Standards, as applicable.

*2. Disclosure of Accounting Policy:* Inadequate or improper disclosure of an accounting policy when it is likely that a user of the financial statements would be misled by the description, should be commented upon.

*3. Impact of comment:* If the impact of an audit comment or the aggregate impact of a number of comments-

- (a) converts profit into loss or vice versa in a financial statement;
- (b) reverses a trend in the accounts generally or in a particular figure;
- (c) increases losses above the limits for disclosure;
- (d) increases the amount in an expenditure head above the threshold that requires an explanation in the account; and
- (e) creates or eliminates the margin of solvency in a balance sheet (post balance sheet events should also be considered).

*4. Repeated comments:* In case certain comments are being repeated in the Statutory Auditor's Report or are not being proposed for issue as C&AG's comments due to low materiality (value) or on which Management has offered an assurance but the same has not been complied with, such comments may be proposed after a cycle of two years.

*5. Money value of the comments:* The materiality of a comment based on the money of individual comments or comments in aggregate should be determined with reference to the degree of impact the comments/comments have on the profit/loss of a year as reported in the Profit/Loss Account and with reference to value of line items the comment pertains to in case of the Balance sheet. The monetary impact of the comments of the statutory auditor that are quantified should also be considered to assess the reasonability of the opinion expressed by them.

*6. C&AG's comments on Statutory Auditor's report:* Comments on Statutory Auditors' Report should be taken in the following cases:

- (a) Non-compliance with Auditing and Assurance Standards of the Institute of Chartered Accountants of India
- (b) Non-compliance with reporting requirements of Companies Act, 1956 including any notifications prescribing reporting requirements under the Companies Act.

- (c) Wrong quantification involving significant variations.
- (d) Non-quantification of major qualifications where it can be demonstrated as quantifiable in supplementary audit and meets the criteria of materiality/ significance by value as listed above. It is reiterated that the monetary values mentioned in these guidelines should not be viewed in isolation of the particular circumstances of the financial statements/ Statutory Auditor's Report.

Sd/-  
Director General (Commercial)

(File No. CA-IV/5-2006)

GLOSSARY OF ABBREVIATIONS

|        |  |
|--------|--|
| AFR    | Annual Financial Results   |
| AGE    | Adhoc Group of Experts   |
| ARCPSE | Audit Review Committee for Comprehensive Appraisals of Public Sector Enterprises |
| AS     | Accounting Standards   |
| BHEL   | Bharat Heavy Electricals Limited   |
| CMD    | Chairman and Managing Director   |
| ITDC   | India Tourism Development Corporation  |
| JPC    | Joint Parliamentary Committee  |
| MD     | Managing Director  |
| ONGC   | Oil and Natural Gas Corporation  |
| QFR    | Quarterly Financial Results  |
| QRB    | Quality Review Board   |
| SAS    | Subordinate Accounts Service   |