

Audit Manual

Part II

Audit of Defence Public Sector Enterprises



Compiled by
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PREFACE

As per the Manual of Standing Orders (Administration) of the Comptroller and Auditor General of India, Deputy Comptroller and Auditor General-cum-Chairman Audit Board is entrusted with the work of Coordination of Audit of Central Government Companies and Corporations and Commercial Audit Reports (Central). The Manual of Commercial Audit Wing of the Office of the Comptroller and Auditor General of India was issued in 1993. This Manual is to be supplemented by manuals issued by respective Principal Directors of Commercial Audit relating to Public Sector Undertakings audited by them. CAG Office also issued guidelines on Performance Audit and Compliance Audit to be followed all Offices.

The Office of the Principal Director of Commercial Audit, Bangalore was functioning under the administrative and technical control of the Commercial Audit Wing in the CAG's Office till March 2012. During that period, the instructions contained in the Manual of Commercial Audit wing of Indian Audit and Accounts Department issued by the Director of Commercial Audit as modified by way of instructions/directions issued by it from time to time. The Manual of the Audit of Department, Defence Services, Air Force and Navy issued during 2007 by the Principal Director of Audit, Air Force and Navy, New Delhi broadly contained instructions on the Audit of Defence Services, Air Force and Navy and served as a supplement to the Commercial Audit Manual.

With the restructuring of the audit offices in the Indian Audit and Accounts Department from April 2012 broadly on sectoral basis, audit of Defence Public Sector Undertakings (DPSUs) was exclusively entrusted to this Office with the administrative control entrusted to the Defence Audit Wing in the CAG's Office. However, regarding technical matters related to audit of annual accounts of DPSUs, the procedures and practices being followed in the Commercial Audit Wing continue to be followed by this office.

One of the major characteristics of the DPSUs is that their ownership (or at least the majority stakes) vests with Government of India (GOI) which through its major Defence Services, viz., the Army, the Air Force and the Navy) under the Ministry of Defence (MoD) is also their major/sole customer. It may, therefore, be necessary while auditing their transactions involving expenditure from the Defence Services to take a holistic view instead of examining them solely from the commercial point of view. Moreover, specific guidelines are in vogue regarding secrecy and confidentiality of matters concerning national security coming to the knowledge of officers and staff of this office. However, the need for a separate manual for dealing with the audit of Defence PSUs persisted considering the requirements of both Commercial and Defence Audit aspects as a part of the Defence Audit Manual in place issued by the Director General of Audit, Defence Services, New Delhi (DGADS) for audit of Defence establishments.

The Comptroller and Auditor General of India (CAG) is the independent public auditor and the Supreme Audit Institution of India (SAI). The existence and mandate of CAG emanates from Article 148 to 151 of the Constitution of India. In compliance with Article 148 (3) and 149 of the Constitution, CAG's DPC Act, 1971 was passed, which lays down the principles to determine whether or not an entity falls within the purview of CAG's audit. Section 143 of the Companies Act, 2013 provides for audit of Government Companies by Comptroller and Auditor General of India. Also, the new CAG Regulations on Audit and Accounts, 2020 have redefined the concept of Government Companies based on control.



(Santosh Kumar)

Principal Director of Commercial Audit

Bengaluru

Date: 9th June 2022

Mandate of the C&AG in regard to audit of Defence Government Companies

As per Section 19 of the CAG's DPC Act 1971, the duties and powers of the Comptroller and Auditor General in relation to the audit of accounts of Government companies shall be performed and exercised by him in accordance with the provisions of the Companies Act, 2013. The Regulations on Audit and Accounts, 2020 contain provisions relating to audit of Government Companies. For the purpose of these Regulations, Government Company means a company owned or controlled, directly or indirectly, by the Central Government, or by any State Government or Governments, or partly by the Central Government and partly by one or more State Governments mentioned in Section 139 of the Companies Act, 2013. Any other company, as appearing in Section 139 of the Companies Act, 2013 has to be read with definition of 'control' in Section 2 (27) of the Companies Act, 2013. In terms of the recommendations of the Perspective Plan 2010-15 and Strategic Defence Audit Plan 2014-2019, the organizational structure of Indian Audit and Accounts Department (IA&AD) has been restructured on sectoral lines to facilitate integration of audit efforts and presentation of a holistic perspective of the Government functioning.

Consequent to restructuring of audit offices in the Indian Audit and Accounts Department in April 2012, Principal Director of Commercial Audit, Bangalore (PDCA, Bangalore) is entrusted with the audit responsibility of nine Defence Public Sector Undertakings (DPSUs) and their subsidiaries which are Government Companies registered under the Companies Act 1956/2013. Ministry of Defence (MoD) is the administrative authority for all the DPSUs. Out of the nine DPSUs, seven DPSUs viz., Bharat Electronics Limited (BEL), BEML Limited (BEML), Bharat Dynamics Limited (BDL), Mishra Dhatu Nigam Limited (MIDHANI), Hindustan Aeronautics Limited (HAL), Mazagoan Dock Shipyard Limited (MDL) and Garden Reach Ship Builders and Engineers (GRSE) are listed companies, which are also governed by Clause 49 of the Listing Agreement. The core competencies of Defence PSUs are in various production/manufacturing segments viz., aeronautics, electronics, ship building, submarine construction, earth moving equipment, special alloys and steels, missiles etc., The Officials will now be the part of Defence wing and will be responsible to Deputy CAG (Defence).

This Manual is based on statutory provisions, rules and regulations, orders, instructions, etc. issued by the Government of India, Comptroller and Auditor General of India from time to time. However, the manual does not override the original requirements and should be read with the provisions in the extant Acts and Rules and in cases of doubt, the provisions and instructions contained in the primary sources would prevail.

The instructions in this Manual are intended to bring together in one place the various procedures and practices essentially required by the officers and staff working in this office for carrying out Certification, Performance and Compliance Audit. While carrying out actual audit, it is imperative to learn from practical experience and use professional judgment in selecting the procedures and techniques best suited for achieving audit objectives and accordingly determine the extent of audit in each instance. It is also expected that officers acquire domain knowledge and be capable of putting them to appropriate use whenever required and transmit to new officers inducted into this office so that the professional approach is sustained. OIOS is the new IT tool which is going to enhance the quality and documentation of Audit. Therefore, all the officials are required to build their technical and IT standards. The management of files will now be on e-office which will facilitate faster decision making and quick response to various administrative and audit issues.

Inspection Section of this office will be responsible for keeping this Manual up-to-date by issue of correction slips as and when changes are needed. Discrepancies, if any, noticed vis-a-vis primary orders as also changes required as a result of matters coming to notice during the course of local audit are to be brought to the notice of this Section for necessary amendment.



(Santosh Kumar)

Principal Director of Commercial Audit

Bengaluru

Date: 9th June 2022

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CHAPTER 1 INTRODUCTION

1.1. Brief History of the Office

- Commercial Audit Office formed on 1st March 1957 under a Deputy Director.
- Its jurisdiction included audit of 12 Central PSUs of States of Mysore (Karnataka), Kerala, Tamil Nadu and Andhra Pradesh and 25 Commercial Undertakings and departmental Undertakings of Government of Mysore.
- The post was upgraded to Chief Auditor in 1965.
- Consequent upon formation of Audit Board in 1969, a new office of MAB and DCA was formed in November 1970 for Southern Region with Bangalore as Headquarters.
- In July 1972, the office was re-designated as MAB and ex-officio DCA, Bangalore and was responsible for audit of 31 Central Government Undertakings.
- In March 1978, the post of Chief Auditor re-designated as Joint Director. Subsequently the post was re-designated as the Director of Commercial Audit and further as Principal Director of Commercial Audit and Ex-officio Member of Audit Board.
- In April 2012, IA& AD was restructured on Sectoral lines to facilitate integration of audit efforts and presentation of a holistic perspective of the Government functioning.
- Consequent on re-structuring, the Principal Director of Commercial Audit & *Ex-officio* Member, Audit Board, Bangalore (PDCA, MAB Bangalore) is entrusted with the audit of Nine Defence Public Sector Undertakings (DPSUs) and their seven subsidiary companies/Joint ventures.
- The Department of Defense Production under Ministry of Defence (MoD) is the Administrative Authority for all the above Nine DPSUs and seven subsidiary/associates/JVs.

1.2 Audit jurisdiction

The audit jurisdiction of this office extends to all aspects of the audit of accounts of the 16 DPSUs (9 DPSUs and 7 Subsidiaries/Joint ventures) assigned to this office and their units/branches located at Bangalore or any other place in India. The 16 DPSUs are as follows:

Sl. No.	Name of DPSU
1	Hindustan Aeronautics Limited, Bangalore (HAL)
2	Bharat Electronics, Bangalore (BEL)
3	BEML Limited, Bangalore (BEML)
4	Bharat Dynamics Limited, Hyderabad (BDL)
5	Mishra Dhatu Nigam Limited, Hyderabad (MIDHANI)
6	Mazagon Dock Limited, Mumbai (MDL)
7	Goa Shipyard Limited, Vasco-da-Gama (GSL)

8	Hindustan Shipyard Limited, Visakhapatnam(HSL)
9	Garden Reach Ship Builders and Engineers, Kolkata
10	BEL Optronics Devices Limited, Pune (BELOP), subsidiary of BEL
11	Vigyan Industries Limited, Tarikere (VIL), subsidiary of BEML
12	BEL THALES System Limited, Bangalore (subsidiary of BEL)
13	Defence Innovation Organisation (DIO)
14	Indo Russia Helicopter Ltd.,(IRHL) subsidiary of HAL
15	Naini Aerospace Limited, (NAeL), subsidiary of HAL
16	Utkarsha Aluminium Dhatu Nigam Limited (UADNL - Joint Venture of Midhani)
17	BEML Land Assets Limited (BLAL - Subsidiary of BEML Limited)*

*Incorporated on 15 July 2021

Audit Jurisdiction			
Year 2020-21 (Rs. in crore)			
Name of PSU	Share Capital	Total Income	Profit/ (Loss)
HAL	334.39	23113.25	3232.96
BEL	243.66	14189.93	2045.62
BEML	41.64	3617.37	74.80
BDL	183.28	2008.37	257.77
MIDHANI	187.34	833.06	166.29
MDL	201.69	4648.92	479.57
GSL	58.20	978.76	127.99
HSL	301.99	403.32	(14.00)
GRSE	114.55	1328.43	153.47
BELOP	84.51	59.53	4.90
VIL	2.79	1.44	(6.12)
BEL Thales	57.62	38.72	3.15
NAINI	50.00	5.40	(11.04)
IRHL	10.00	0.53	(0.80)
DIO	0.01	1.08	---
UADNL	40.00	0.75	0.38
BLAL	NA (Incorporated on 15 July 2021)		

1.3. Profile of the auditee DPSUs:

Nine Defence PSUs and seven subsidiary / Joint venture companies, in the audit domain of the office encompass various business segments like aerospace, earthmoving, railways, electronics, shipbuilding, submarine construction, steels and alloys, missiles and various defence products. The customer base includes three defence services, Coast guard, PSUs and others. Considering the above scenario, the audit responsibility increases in ensuring production and utilization of resources. Attaining and updating the knowledge of the industry, technology, market, infrastructure facility, quality, competitors, JVs/PPP business etc. assumes utmost importance. The economy, efficiency and effectiveness to be exercised

by the management in managing the business in a climate of growing competence are challenging. Focused cost reduction techniques needs to be mapped in order to be competitive. The sphere of focal/crucial points to be covered in the audit spreads/multiply and hence needs to be defined. Three year Rolling Audit Plan is drawn considering these factors. An overview of nine Defence PSUs and seven subsidiary/ Joint Venture companies is given in **Annexure-I.**

1.4. Matters related to DPSUs requiring examination of records at/by other offices

All the DPSUs in the audit jurisdiction of this office are under the administrative control of the Ministry of Defence (MoD). As such, issues beyond the delegated powers of the DPSUs would have been examined and decided at the Ministry and its subordinate formations or related bodies/authorities such as Cabinet Committee on Security, Defence Acquisition Council, Regional Centre for Military Airworthiness, Centre for Military Airworthiness and Certification, Defence Research and Development Organisation and its laboratories and autonomous bodies, etc.

Moreover, records of bodies set up for programme management, monitoring, notices inviting tender, tender evaluation documents, request for proposal, price/contract negotiations committee, etc. not available with DPSUs may need to be looked into . Apart from these, the decisions taken or directions issued on review of periodical returns furnished by the DPSUs to MoD including those relating to achievements with reference to the targets set in the annual Memorandum of Understanding (MoU) also need to be examined. Besides these, records of other Ministries/Departments with whom the DPSUs may have had transactions may also need to be examined.

Since audit jurisdiction of those records vest with the respective defence audit offices, arrangements need to be made with those offices either for access to the records required or data/information to be provided to this office after conducting audit themselves. Such arrangements are also required to be made in cases where integrated audit is taken up on a topic involving scrutiny of records by more than one audit office.

CHAPTER 2 ORGANISATIONAL SET UP

2.1 General

The office is headed by the Principal Director of Commercial Audit & *ex officio* Member, Audit Board (PDCA) with headquarters at Bengaluru.

There are two Groups known as (i) Administration & Inspection Group (ii) Reports Group presently in charge of Deputy Director (Administration) and Deputy Director (Reports) respectively.

For the purpose of exercise of financial powers, PDCA is the head of the department and Deputy Director (Administration) is the head of the office.

2.2 Structure of the office and allocation of work

2.2.1 The audit of 16 DPSUs are allocated between the two Groups. Deputy Director (Reports) is in charge of seven¹ DPSUs. Deputy Director (Administration) is in charge of the nine² DPSUs besides the administration of the office as a whole. At the headquarters, the work is mainly distributed in three Sections, viz., Reports Section under Deputy Director (Reports) and Administration and Inspection Sections under Deputy Director (Administration), each Section being headed by a Senior Audit Officer.

Till 31 October 2011, audit was being conducted by Resident Audit Parties (RAPs). In pursuance of CAG's instructions, effective from 1st November 2011, field audits are being conducted by deputing parties from main office, known as Local Audit Parties (LAPs). However, the outstation RAPs at Nashik and Lucknow are continued.

(Authority: Hqrs letter No.633/CA IV/8-2010 dated 27 September 2011)

2.2.2. The field local audit work is carried out through two RAPs and 15 LAPs. The allocation of Companies/their branches or units to RAPs and LAPs are in accordance with the circular No. Inspection/ Allocation of work to LAPs/ 2021-22/ 37 dated 23.08.2021.

2.3. Functions of the Inspection and Reports Sections at Main Office

The major functions of the Inspection and Reports Sections of Main Office include:

- Maintenance of data base of auditable units of the DPSUs and their branches ;
- Preparation of rolling and annual audit plans;
- Selection of units for audit and arranging conduct of local audit by preparation of detailed quarterly programmes;
- Vetting, issue and pursuance of Inspection Reports;

¹ Hindustan Aeronautics Limited, Mazagon Dock Limited, Goa Shipyard Limited, Hindustan Shipyard Limited, arden Reach Shipbuilders and Engineers, Naini Aerospace Limited, (NAeL), Indo Russia Helicopter Ltd.

² Bharat Electronics, BEML Limited, Bharat Dynamics Limited, Mishra Dhatu Nigam Limited, BEL Optronic Devices Limited, Vigyan Industries Limited, BEL Thales systems Limited., Defence Innovation Organisation and Utkarsha Aluminium Dhatu Nigam Limited

- Processing observations made during financial audit for issue of comments and issue of audit certificate;
- Preparation of material for the CAG's Audit Reports;
- Finalization of vetting remarks on Action Taken Notes received in respect of comments/ paragraphs included in the CAG's Audit Reports;
- Arranging meetings with Senior Management Executives of the individual DPSUs whenever required and more specifically for pre-accounts and post-accounts discussions, entry and exit conferences for performance audit;
- Collecting data regarding meetings of DPSUs' Board of Directors and its committees and arranging review of their agenda and proceedings by audit parties;
- Arranging training of officers and staff in various areas after conducting a training needs analysis;
- Maintenance of registers for watching settlement of Inspection Reports, Potential Draft Paragraphs, Draft Paragraphs, Money Value Objections, Paragraphs in the CAG's Audit Reports, etc.

Detailed instructions regarding the manner in carrying out these functions are contained in the subsequent chapters.

2.4. Functions of the Local Audit Parties

2.4.1 The Local Audit Parties (LAPs) are required to carry out the audit assigned to them within the time schedule in the premises of the auditable unit. In the case of multi unit undertakings, the duty list for each party will be finalized by PDCA. The inspecting officer will remain responsible for the efficiency of the inspection as a whole, though some items of work may, in accordance with the local instructions or local usage, be entrusted to the subordinate staff. He/She must guide the members of the party in their work and determine the extent of independent action to be allowed to each member with reference to the experience, qualities and capacity to act.

(MSO Audit – para 6.1.7 and 6.1.8).

2.4.2. Their functions include studying the operations of the unit, relations with its corporate office, investment activities of the Companies, previous audit observations, internal control measures in place and obtaining all the statistical data. They are required to carry out a risk assessment, prepare an audit plan focusing on areas identified as risk prone and wherever necessary apply a suitable statistical sampling technique and the checks prescribed for the relevant transactions/records and complete the audit. The Detailed instructions regarding the manner of conducting the audit are contained in the subsequent chapters.

2.4.3. In the Audit Board Meeting held on 29 June 2016 checklist and matrix on Audit of Contracts was deliberated upon and DAI(C) has approved the Audit Design Matrix and checklist on Audit of Contracts. The LAP is required to prepare a Contract Audit Check List as an assurance mechanism to ensure that due diligence has been exercised by the LAP during audit of contracts. It consists of three parts viz., selection of sample of contracts for audit, Audit design matrix and Matrix for audit of contracts.

(Hqrs letter No. 143/ CAIV/ 02-2015/ Contract Audit dated 11.06.2015).

2.4.4. LAP shall submit the Contract Audit Matrix along with the draft inspection reports and which are to be scrutinized at the time of their vetting and submitted to the Group Officer/PDCA. The monthly return prescribed in this regard is to be compiled and submitted by the concerned Section in the Main Office.

2.4.5. The LAP They should also maintain a Register of High Value Contracts and submit review notes to the Group Officer/PDCA. They should also furnish a Quarterly return (by 5th of April, July, October and January) showing the number of contracts outstanding to be reviewed at commencement of the quarter, additional cases received during the quarter, number reviewed during the quarter, and the number of cases outstanding to be reviewed at the end of the Quarter with results of audit.

2.5. Functions of the Resident Audit Parties

The Resident Audit Parties (RAPs) performs functions similar to that of LAPs. The only difference is that these parties are stationed at one of the DPSU Divisions. The audit of other divisions is attached to them. The audit plans are prepared and approved by the Group officer. The responsibility of the Inspecting officer as brought out under Paragraph 2.4 is applicable to the Inspecting officer of the Resident Audit Party.

CHAPTER 3

PREPARATION OF AUDIT PLAN

3.1. General scope and extent of audit

Under Section 23 of the CAG's (DPC) Act, the scope and extent of audit are determined by the CAG. Section 24 of the said Act empowers the CAG to dispense with any part of detailed audit of any accounts or class of transactions and apply such limited check in relation to such accounts or transactions as determined by him.

3.1.1. Scope of audit

In exercise of the CAG's mandate, three broad categories of audit, viz., financial audit, compliance audit and performance audit are undertaken. This does not preclude taking up any other type of audit. The scope of each type of audit is determined to ensure achievement of the objectives of the audit.

3.1.2. Extent of audit

The quantum of audit including the period, the units of the auditable entity, the extent of test check and the boundaries of audit enquiry are generally laid down or are decided on case to case basis for each type of audit. The provisions in the Memorandum of Secret Instructions regarding the extent of audit and other circulars issued from time to time under the authority of the CAG on the quantum and extent of audit derive their authority from this Section of the Act. Under the delegated powers, this office has prescribed certain quantum of checks in respect of a few transactions.

3.2. Audit planning

The Perspective Plan of the Indian Audit and Accounts Department (IA&AD) for 2010-2015 outlines the goals to realise the Vision and Mission of the Department. It required preparation of a Strategic Audit Plan for each Functional Wing/Field Office dovetailed with the Strategic Audit Plan of the Department and ensure that the Annual Audit Plans flow from it. The Task Force constituted by Hqrs. Office to prepare Strategic/Audit Plan concluded its proceedings in September 2018 with the recommendation that instead of Strategic Audit Plan functional wings may prepare three year Rolling Audit Plan (RAP). The Annual audit Plans in alignment with the three year rolling audit plan would continue to be prepared as per the usual practice.

(Authority: CAG UO NO. 507/130-Defence/2018/D/9/12/11/2018)

3.2.1. Defence Audit Advisory Board

DAI (Defence) ordered constitution of Defence Audit Advisory Board (DAAB) on the lines of the Audit Advisory Board constituted by the CAG at headquarters. The objective of constitution of these bodies in Defence Audit would be to enhance the effectiveness of audit including Audit Reports by providing a forum for professional discussion between the senior management of Defence Audit offices and knowledgeable and experienced professionals from varied fields. A set of guidelines for constitution of the DAAB had been laid down.

Hqrs. Office instructed to nominate DG (Defence) as *ex-officio* Member in all the Audit Advisory Boards.

Function of DAAB is to advise the Principal Directors of Audit on coverage, scope and prioritization of audits together with suggestions regarding appropriate audit approaches and techniques. DAAB shall also suggest topics/ issues for greater audit impact.

(Authority: CAG UO No. 161/213 Defence and Communication/2016 dated 13-05-2019 and No.212/213 Defence and Communication/2016 dated 20-06-2019)

Accordingly, this office has formed an 'Defence Audit Advisory Board' with the approval of Deputy C&AG in July 2019 with four external members from the DPSUs. The tenure of each member will be one year. At least two meetings would be held every year, one before finalizing the audit plans and another when the findings of two quarterly audit plans are available. Hqrs. Office has directed that the selection of topics for ensuing two years may be included in the agenda of the meeting.

3.2.2. Audit Planning Group and Audit Planning Cell

As per the requirements of paragraph 2.1.27 of the Manual of Standing Orders (Audit), this office has an Audit Planning Group (APG) headed by the Principal Director of Commercial Audit with both the Group Officers and the Branch Officers of Reports and Inspection Sections as its members. In addition to macro-level planning (Rolling and Annual), the APG should ensure that detailed unit-level audit planning is embedded in the audit process, especially for compliance audit. It functions as the apex monitoring body for the office and to review/watch progress of implementation of the audit plan and is required to be convened at least once in every quarter.

The Inspection Section will also function as the Audit Planning Cell (APC) and be responsible for maintenance of data base, risk assessment and compile the results of Quarterly Audit Programmes for submission to APG for review. APC will also prepare deviations to the approved plan for clearance by APG.

3.2.3. Rolling Audit Plan

Instructions contained in Chapter 3 of Compliance Auditing Guidelines (2016) relating to Compliance Audit plan defining and risk profiling of apex auditable entities and audit units should be kept in mind while preparing the detailed plan for audit during the span of three years. It has to be ensured that the focus of the audit should be on systemic issues envisaging shortcomings of doctrine, policy, training, or supervision having an overall impact on operational readiness of the defence services rather than individual inconsistencies/errors e.g. self reliance/Indigenous production policy, defence modernization, decision making processes.

(Authority: CAG UO NO. 507/130-Defence/2018/D/9/12/11/2018)

3.2.4. Annual Audit Plan

Every year, considering the approved Rolling Audit Plan, an Annual Audit Plan (AAP) for the ensuing financial year is required to be prepared. This is prepared by this office duly considering significant changes in the audited entities environment and other factors. The AAP is to be forwarded to the CAG's Office by February of every year for approval. The AAP may be amended in the course of its implementation in case the necessity for doing so arises subject to intimation of the same to the CAG's Office.

The Annual Audit Plan will be prepared considering SAOs and AAOs in field as on 31st March of previous financial year. Further, as per minutes of the XIII Audit Board meeting held on 18th & 19th November 2013 and Headquarters instructions, 237 mandays per Officer (SAO/AAO) is to be considered as working days for preparation of Annual Audit Plan without providing any deduction for leave, training, Transit and Entrustment of other audits. A Monthly/ Quarterly review is to be done with regard to the utilization of mandays and shortfall, if any, would be adjusted during the subsequent months/ quarters in order to ensure optimum utilization of manpower. Further, the units which cannot be covered is also to be reviewed quarterly and accordingly adjusted in the subsequent quarters in order to ensure the coverage of all the units planned in the AAP.

*(Headquarters letter No. 941/CA-IV/96-2010 dated 27.11.2013 and
U.O. No. 115/Def/8/2022/Part V dated 25.03.2022)*

3.2.5. Quarterly Audit Programmes

Based on the approved AAP, detailed audit programmes are to be drawn up for each quarter of a financial year at least 15 days before commencement of the quarter. These are to be approved by the Principal Director of Commercial Audit.

3.2.6. Steps in audit planning

Audit planning would involve the following steps:

- Classification of DPSUs based on their size and scale of operations;
- Understanding the business activities of DPSUs and associated risks;
- Identification of activities and theme carried out by DPSUs;
- Selection of theme/activity for audit based on scientific risk assessment;
- Selection of units of DPSUs to audit the selected theme/activity;
- Allocation of audit resources based on scale of operations and business risk; and selection of sample, documentation, preparation of report and their follow up.

Each of the steps is explained in the chapter on respective types of audit.

3.2.7. Risk assessment

Preparatory to initiation of action for the audit plan, a detailed, formal and documented assessment of significant risk factors is required to be carried out. For this purpose, the instructions contained in the CAG's Office letter No.411/CA IV/70-2003/Vol.III dated 3.9.2008 are to be kept in view. Depending on the potential risks identified, the scope of audit, sample size, timeframe and resources, detailed audit guidelines and checklists are to be drawn up for audit of different functional areas and communicated to field audit teams.

Further, the Compliance Auditing Guidelines issued in February 2016 outlines the principles, objectives, approach, methodology, techniques and procedures for conducting compliance audit and this also may be considered.

The criteria for selection of a Public Sector Undertaking for annual accounts audit are laid down in Headquarters letters No.31/CA IV/12-1998/Vol.II dated 28.1.2011 and No. 176/CA-IV/ 12-2022 dated 31.05.2022. As per the revised criteria intimated vide letter No. 176/CA-IV/ 12-2022 dated 31.05.2022, the supplementary audit of financial statements of CPSEs with turnover of Rs. 1000 crore or more or with paid up capital of Rs. 250 crore or more must be taken up every year. All other CPSEs must be taken up for supplementary audit at least once in four years. Field Offices may also take up any number of CPSEs for supplementary

audit every year in addition to the above based on their respective assessment of risk. These revised criteria would be applicable for audit of financial statements of CPSEs for financial year 2021-22 onwards.

While complying with these norms, it should be ensured that no auditable entity is left uncovered for more than four years continuously for financial audit and more than 3 years for compliance audit.

3.3. Review of Agenda Notes and Minutes of meetings of the Board of Directors and other committees

Every DPSU is required to provide the Agenda Notes and Minutes of the meetings of its Board of Directors, board level committees and the audit committee, if formed, to Audit.

Instructions have been issued during October 2019 that all the Board papers are reviewed for each company at Corporate Office level on quarterly basis. The Board minutes review should be completed before the commencement of Certification/Compliance audit. The review remarks should be submitted to main office/LAPs. The review remarks of LAPs/RAPs on Agenda Notes and Minutes of the meetings of Board of Directors and Audit Committee are to be submitted along with the draft Inspection Report.

(Authority: OM No. PDCA/Sectt./2019-20/31 dated 10-10-2019)

3.4. Advance intimation to the auditee unit

Unless an element of surprise check is involved, immediately on approval of the Quarterly Audit Programme by the Group Officer, the concerned Section should send an intimation of the proposed programme of audit to the officer in charge of each office to be audited. As far as possible, the intimation should allow a minimum period of three weeks to the auditable entity to make arrangements for production of records. The intimation for audit should state the likely duration of the audit and also provide a list of the basic records that should be kept ready before the arrival of the audit team (177 of Audit Regulation). A standard form of intimation has been prescribed vide Hqrs letter No.322/CA IV/25-2008 dated 25 July 2008.

The detailed procedure for conduct of Financial, Performance and Compliance Audits explained in subsequent chapters.

CHAPTER 4

FINANCIAL AUDIT

4.1. General

The purpose of an audit of financial statements is to enhance the degree of confidence of intended users in the financial statements. This is achieved through the expression of an opinion by the auditor as to whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework, or – in the case of financial statements prepared in accordance with a fair presentation financial reporting framework – whether the financial statements are presented fairly, in all material respects, or give a true and fair view, in accordance with that framework.

4.2. Audit of financial statements of DPSUs by CAG

4.2.1. The audit of accounts of DPSUs, being Government companies, is conducted by this office by virtue of the provisions of Section 19 (1) of the CAG's (DPC) Act, 1971 as amended from time to time. These provisions specify that the related duties and powers shall be performed and exercised in accordance with the provisions of the Companies Act, 1956 replaced by the Companies Act, 2013.

4.2.2. In terms of Section 143(6) of the Companies Act, 2013, the CAG shall, within sixty days from the date of receipt of the Audit Report under Sub-section 5 of Section 143 have the right to conduct supplementary audit and comment upon or supplement such audit report. Section 143 (6) read with Section 136 enjoins on each company to place before its Annual General Meeting, the statutory auditor's audit report, together with the CAG's comments upon or supplement to it, in the prescribed manner.

4.2.3. Section 143(7) read with section 143(5) or Sub-section 7 of section 139 of the Companies Act, 2013 also empowers the CAG (and hence this office) to conduct a test audit of a Company's accounts.

4.2.4. The Companies Act, 2013 defines the term "Financial statements" to include the following:

- (i) Balance Sheet as at the end of the financial year;
- (ii) Profit and Loss account for the financial year;
- (iii) Cash flow statement for the financial year;
- (iv) Statement of change in equity, if applicable, and
- (v) Any explanatory note forming part of the above statements.

4.3. Appointment of Statutory Auditors

4.3.1. By virtue of the provisions of Section 139 (5 and 7) read with Section 143 (5) of the Companies Act 2013, CAG appoints or reappoints the Auditor (hereafter called as Statutory Auditors) for each Government Company and its branches/units preparing separate accounts. Copies of the CAG's orders of appointment of statutory auditors are also endorsed to this Office. The statutory auditor is required to submit a copy of his audit report to the CAG.

4.3.2. The appointments are communicated through individual letters issued to the companies which include the list of branch auditors for each branch of that company. The letters include the terms and conditions of the appointments which are subject to their acceptance being communicated to the company, to the CAG's office and to this office. The letters also contain the conditions applicable for the companies in connection with the appointments. In terms of Section 142 of the Companies Act, 2013 read with the guidelines issued by the Department of Company Affairs in its notification No.7/76 dated 08.04.1976 and No.8/6/83 dated 7th June 1984 the remuneration (and other allowances) of the auditors of a company is to be fixed by the company in general meeting. However, the appointment letters indicate amount of fees as intimated by the Company.

4.4. Issue of Directions to Statutory Auditors by CAG

4.4.1. By Section 143 (5) of said Act, the CAG also directs the manner in which the Company's accounts are to be audited and gives instructions/directions from time to time to the statutory auditor with regard to any matter relating to the performance of his functions. The recent (2020-21) directions issued by the C&AG under section 143(5) of Companies Act 2013 applicable from the year 2020-21 and onwards are given below:

I. Whether the company has system in place to process all the accounting transactions through IT system? If yes, the implications of processing of accounting transactions outside IT system on the integrity of the accounts along with the financial implications, if any, may be stated.

II. Whether there is any restructuring of an existing loan or cases of waiver/write off of debts /loans/interest etc. made by a lender to the company due to the company's inability to repay the loan? If yes, the financial impact may be stated. Whether such cases are properly accounted for? ((In case, lender is a Government Company, then this direction is also applicable for statutory auditor of lender company).

III. Whether funds (grants/subsidy etc.) received/receivable for specific schemes from Central/ State agencies were properly accounted for/ utilized as per its term and conditions? List the cases of deviation.

In addition, the auditor is required to comply with any additional Company / Sector specific directions issued under section 143(5) of the Companies Act, 2013 by the field office entrusted with the supplementary audit of the Company.

(Letter no. 105/CA-II/Dir-Sub Dir/II-2015/Vol II dated 16.02.2021)

4.4.2. In the 14th Audit Board meeting held on 17 and 18 February 2014, CAG decided (Circular No.14/D&C/2014/198 dated 21-4-2014) that in the background of the new Companies Act, 2013, the expression 'sub-directions under section 619(3)(a) of the erstwhile Companies Act, 1956' is to be replaced by 'preliminary observation(s)'. It has also been laid down that no sub-directions are issued without approval of Hqrs. office and only preliminary observations may be issued, if required seeking views of the statutory auditors on specific issues.

4.5. Conduct of Audit by the statutory auditor

4.5.1. The statutory auditor shall document, in the form of working papers, matters which are important in providing evidence that the audit has been carried out in accordance with the accounting, auditing and assurance standards prescribed by the Central Government/ICAI and the directions of the Comptroller and Auditor General.

(62 of Audit Regulations 2020)

4.5.2. After completion of the audit, the statutory auditor is required to prepare his audit report under the Companies Act, 2013 and submit a copy to this office.

(63 of Audit Regulations 2020)

The statutory auditor, at the time of submission of his report under the Companies Act, 2013, shall also forward to this Office a copy of any communication containing matters of governance issued by him to the management of the company in compliance with the relevant accounting, auditing and assurance standards prescribed by Central Government/ICAI.

(64 of Audit Regulations 2020)

4.5.3. Responsibilities of Statutory auditor

The statutory auditor shall also:

- (1) make himself available for discussions with the office of the Comptroller and Auditor General and this Office as and when required;
- (2) furnish reply to the provisional comments within three days of issue and, if required, attend the meeting called by this Office with the management of the company to discuss the provisional comments;
- (3) attend the meetings of the audit committee, if formed, held in pursuance of the Companies Act, 2013;
- (4) retain the record of work done by him in the form of working papers with sufficient details so as to support his observations and conclusions for a period of five years unless required for a longer period;
- (5) make portions of or extracts from his working papers available to this Office in cases where it is considered necessary by Audit to verify the authenticity and correctness of the conclusions drawn in his audit report; and
- (6) submit to the Comptroller and Auditor General through this Office, a report under the Companies Act, 2013 in compliance with the directions issued to him.

(65 of Audit Regulations 2020)

4.6. Holding of pre-accounts meeting with the management of the Company

Section 96 (1) of the Companies Act, 2013 requires every company other than one Person Company to hold its annual general meeting in each year within 15 months of similar meeting for the previous year. Section 129(2) of the said Act enjoins on its Board of Directors to lay in the company's annual general meeting the financial statements for the financial year. Section 143 (6) of the said Act requires that any comments upon or supplement to the (statutory auditor's) Audit Report is to be placed before the annual general meeting of the company at the same time and in the same manner as the audit report. In respect of a Government company where the Central Government is a member, Section 394(1) of the Companies Act, 2013 requires that Government to cause to prepare an annual report on the working and affairs of the company and to be laid before both Houses of Parliament together with the audit report and any comment upon or supplement by the CAG thereto.

In view of the timelines required to be adhered to, it would be necessary to work out a detailed schedule for availability of accounts for audit at each stage and to monitor it scrupulously. To facilitate this, a pre-accounts meeting is to be arranged by Reports/Inspection Section, as the case may be, in February every year with the management of the company and the statutory auditors. After the meeting, minutes thereof are to be prepared and confirmation obtained from the management and the statutory auditor.

4.7. Scope of financial audit

4.7.1. It is the statutory auditor who is primarily responsible for expressing an opinion on the accounts of the company. Supplementary audit of the accounts by the Comptroller and Auditor General is, by its very definition, mainly an instrument of quality control of financial audit of accounts that begins with careful selection of the statutory auditor and continues with the ongoing oversight of his work including review of the conclusions drawn in his audit report. The scope of supplementary audit of annual accounts of a Government company and any other company by the Comptroller and Auditor General shall include an examination of selected accounting records and a review of the audit report of the statutory auditor including the opinion expressed by him on the annual accounts of the company.

(68 of Audit Regulations 2020)

4.7.2. Considering that there is a need to change the audit approach to 'making value addition in better presentation of financial statements of the PSUs instead of counting financial impact of comments', implementation of guidelines for interim audit of annual accounts commenced from the annual accounts of 2008-09. Accordingly, a three-phased audit of annual accounts of all the DPSUs (except subsidiaries & JV) had been in vogue from the annual accounts of 2009-10 till 2018-19.

A need was felt to review the three phased audit system and based on the views of the field offices and discussion with the senior management, it has been decided to discontinue the three phased audit system with immediate effect except in cases of statutory corporations where CAG is the sole auditor.

(Authority: CAG letter No.73/CA-II/Three phase audit/06-2019 dated 20-09-2019)

4.8. Methodology of Financial audit

4.8.1. The Government company shall make available the Balance Sheet and the Statement of Profit and Loss and any other statements or documents declared under the Companies Act, 2013 to be part of annual accounts duly adopted by the board of directors and audited by the statutory auditor to this Office by giving sixty days time for conducting supplementary audit and issue of comments of the Comptroller and Auditor General.

(66 of Audit Regulations 2020)

In case of receipt of standalone financial statements (SFS) along with Consolidated Financial Statements (CFS) or CFS is received within a reasonable time (up to four weeks), sixty days may be counted from the date of receipt of standalone accounts. In case of delayed receipt of CFS (beyond four weeks), audit comment on the standalone accounts may be processed separately.

(circular No. II/CA-II/PC/01-2016 dated 22.02.2016)

Any comments given by the Comptroller and Auditor General upon, or supplement to, the audit report shall be sent by the company to every person entitled to copies of audited financial statements and also be placed before the annual general meeting of the company at the same time and in the same manner as the audit report.

(66 of Audit Regulations 2020)

4.8.2. Every Company is required to make available to this office two sets of financial statements for timely finalisation and issue of comments and for subsequently holding its Annual General Meeting within the time stipulated in the Companies Act, 2013. One set of

the annual accounts as received by this office is to be immediately forwarded to the Director General (Defence) in the CAG's Office.

4.8.3. On receipt of the certified annual accounts from the company, the Reports/Inspection Section is required to conduct an analytical review to ascertain abnormal variations with reference to the accounts of the previous two years. The review would cover changes, if any, in accounting policies, notes to accounts, disclosures and qualifications by the statutory auditors. The results of the review are to be communicated to the local audit party while taking up audit of the accounts of the company.

4.8.4. As a matter of convention, all the nine DPSUs are being covered under the Audit. For selection of branches of multi-unit companies, a proper and scientific audit risk assessment is to be carried out every year and approval of PDCA obtained for taking up their audit.

4.9. Selection of PSUs for certification Audit

The criteria for selection of a Public Sector Undertaking for annual accounts audit are laid down in Headquarters letters No.31/CA IV/12-1998/Vol.II dated 28.1.2011 and No. 176/CA-IV/ 12-2022 dated 31.05.2022. As per the revised criteria intimated vide letter No. 176/CA-IV/ 12-2022 dated 31.05.2022, the supplementary audit of financial statements of CPSEs with turnover of Rs. 1000 crore or more or with paid up capital of Rs. 250 crore or more must be taken up every year. All other CPSEs must be taken up for supplementary audit at least once in four years. Field Offices may also take up any number of CPSEs for supplementary audit every year in addition to the above based on their respective assessment of risk. These revised criteria would be applicable for audit of financial statements of CPSEs for financial year 2021-22 onwards.

While complying with these norms, it should be ensured that no auditable entity is left uncovered for more than four years continuously for certification audit.

4.10. Conduct of Financial Audit

4.10.1. The Indian Accounting Standards (Ind AS), as notified by Ministry of Corporate Affairs (MCA) on 16 February 2015 in pursuance of the provisions of Section 133 read with section 469 of the Companies Act, 2013 effective from April 2015 and the standard audit practices issued by the Institute of Chartered Accountants of India (ICAI) should be kept in view while carrying out the audit.

4.10.2. The aspects that could be covered in audit would include:

- Conducting a proper risk assessment including review of internal control system; work out the quantum of checks to be exercised, departments/units to be visited, scope and coverage;
- Analysis of accounting policies, notes to accounts with reference to applicable laws and disclosures in conformity with the Indian accounting standards, issues of principle, opinions of the Expert Advisory Committee of ICAI; emphasis should be placed on changes made/proposed from those of the previous year; CAG's Office has emphasized that significant accounting policies, more importantly revenue recognition, are to be reviewed along with substance of major contracts;
- Consistency in the accounting policies of the companies in the same sector;
- Action taken on audit comments and compliance with assurances given by the management and on issues raised in the Management Letter(s) issued in connection with the accounts of the previous year; and

- Modifications in opening balances or rectification of errors made by the company to evaluate the efficacy of the company's internal control system.
- Review of the system of verification of inventories, cash and bank balances including fixed deposits, investments and other items to be finalized at year end and the system of confirmation of balances of debtors, creditors, loans and advances, etc.
- Instructions issued by the Corporate office of the company to its branches/units for compilation/consolidation of accounts for the year including grouping or closing entries to be passed vis-à-vis the applicable accounting standards, declared accounting policies, contractual terms, etc.
- Accuracy of accounting estimates made by the managements or by outside experts as in actuarial valuation. The accuracy and validity of assumptions and data inputs which go into accounting estimates need to be examined. Consistency of assumptions also needs to be examined.
- Provision for doubtful accounts and advances/deposits/receivables from contractors, especially those overdue;
- Fair valuation of complex financial instruments not traded in active and open market;
- Provision against carrying amount of investments where there is uncertainty regarding recovery with emphasis on investments in non-performing or loss making joint ventures/ subsidiaries/ associates may be a special area of concern;
- Accounting of deferred tax assets and liabilities specially by loss making companies;
- Property and equipment retired from active use and held for sale;
- Obsolescence, provision for non-moving stores and inventory and physical verification thereof;
- Warranty obligations;
- Writing back of provision no longer required;
- Financial obligations/costs arising out of litigation settlements and judgments;
- Outcome of long term contracts especially estimation of cost of completion in case of adoption of proportionate completion method for accounting of revenue from contracts;
- Fair value of cash generating units for ascertaining provision for impairment;
- Provision for liquidated damages, automatic price adjustment, contractual liabilities/obligations;
- Provision for onerous contracts
- Liabilities towards retirement benefits.
- Capitalisation of capital work-in-progress;
- Accounting of capital expenditure as revenue expenditure;
- Classification of spares as machinery spares or capital or store spares;
- Independent third party confirmation of balances, reconciliation and accounting adjustment for differences;
- Balance lying in suspense or un-reconciled amount under inter-unit balances;
- Advancement of accounting of revenue and setting up of sales;
- Accounting of work-in-progress especially in case of accounting of revenue under proportionate completion method;
- Accounting of grant/subsidy under a scheme approved by the government pending approval of the grant/subsidy;
- Postponement of expenditure by changing cutoff date with reference to the previous year, liquidated damages, warranty by disclosing the same as claims not acknowledged as debt;

- Accounting of claims which have not been formally lodged (customs refunds, etc.);
- Accounting of interest on loans and advances specially overdue interest;
- Accounting of foreign exchange transactions particularly the foreign exchange losses on high value fixed assets; adoption of correct and applicable rate of exchange for accounting of transactions;
- Disclosure about non-execution of title deeds of lands;
- Disclosure about encroached land;
- Disclosure on asset not put to use;
- Disclosure of assets on land not owned by the company;
- Disclosure about corporate guarantee and letter of comfort given by the company;
- Income from core activity being less than other income;
- In case of Public Private Partnership Projects, aspects useful for transaction audit also need to be examined; these would include delay in collection of amounts due to the company and the basis for arriving at the amount receivable;
- Accounting of discount of commercial papers, bonds, etc. if any, issued by the company.
- Compliance with accounting, consolidation and grouping instructions;
- Accounting and disclosures of the events which occurred after the balance sheet date;
- Compliance with the financial reporting requirements of the relevant laws, rules and regulations, accounting standards, etc.; and
- Examination of the reports of the statutory auditors especially the qualifications, opinions and compliance with the relevant Auditing and Assurance Standards.

4.10.3. To ensure compliance with application of the audit checks/instructions issued from time to time, a Title Sheet in respect of each accounts (and branch accounts, where applicable) of each Company in the prescribed form (**Appendix 2**) duly completed is required to be submitted by the audit party to the Group Officer concerned.

Further, the headquarters instruction vide letter NO. 292 CA-IV/74-2006 dt. July 2007 has prescribed a compliance certificate to provide an assurance that all audit checks prescribed therein for supplementary audit have been carried out. The compliance certificate has to be sent to Headquarters Office along with draft comments/Nil comments.

4.11. Holding of meeting with management of each DPSU to discuss major audit findings

4.11.1. Apart from obtaining written replies to the observations made on accounts, a meeting with higher executives of the management of the company and the statutory auditors is arranged for obtaining further clarifications before reiterating the audit view. In respect of multi-unit companies, the observations to be brought up in such meetings are to be classified by issues for facility of deliberations. Considering materiality and significance of the issues, where necessary and sufficient, assurances from the management are to be sought for regarding action that would be taken by them in the immediate future. After the meeting, formal minutes of the meeting are to be drawn up and confirmation obtained from the participants for reference and record.

4.11.2. After receipt of confirmation, assurances are to be obtained in writing and kept on record for drawing up Management Letters and for further pursuance at the level of this office, CAG's Office has emphasised that assurances should be obtained very cautiously only for minor issues; all major observations which impact the profitability and performance of the

companies should be vigorously pursued and assurances on such issues should be avoided. CAG's Office has 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 judgement.

4.11.3. In case of Maharatna, Navratna, Miniratna (Category-I &II) CPSEs, where no provisional comments were issued, the field offices besides seeking Headquarters approval before issuing 'Nil' comment certificate would also send to Headquarters the annotated statement containing all Half Margins (Audit Enquiries) issued during the course of supplementary audit, management and statutory auditors reply thereto and further remarks of the field office for not pursuing Audit Enquiries. The Nil comments proposal should reach Headquarters by 45th day from the date of receipt of financial statements of Maharatna, Navratna, Miniratna (Category-I &II) CPSEs at field offices.

(Headquarters Letter No. 223-CA-IV/16-2021 dated 16.07.2021)

4.12. Procedure for Issue of provisional Comments to DPSUs

4.12.1. Where the replies furnished to the audit observations are found to be not acceptable, provisional comments are to be issued to the statutory auditors and the company specifying time limit for furnishing their replies. The replies received are to be properly examined at the level of PDCA to arrive at an appropriate decision regarding their further pursuance.

4.12.2. In case a comment on accounts is being repeated over the years, the office should review the comment based on replies of the management and Statutory Auditors and take decision in right perspective rather than repeating the comment based on previous year's judgment. A joint meeting with management and auditor may be called to settle the issue rather than comment as a matter of routine. The cases, where the same irregularity persists and no corrective action has been taken by the management, such cases should be brought to the notice of the concerned Ministry through Headquarters office.

4.12.3. The C&AG has issued guidelines on taking of 'assurance' and dropping of comments on the basis of assurance by the management in Supplementary audit (vide letter No. 226/CA-IV/4-98-Vol-II dated 04.05.2006). The same should be followed during finalization of provisional comments.

4.12.4. The general principle that should be applied while deciding to drop one provisional comment is whether it is material or not. In case the amount involved or the impact of provisional comment on true and fair view of the financial statements is material, the comment should be proposed. If management offers to refer the issue raised in the provisional comment to an expert group, the same should be indicated in the aide-memoire being sent to the head quarters office along with the proposed comment.

4.12.5. In addition, the following may also be suitable basis for proposing comments despite management's offering assurances.

- The provisional comments highlighting frequent changes in the accounting policies with a view to influence the working results of the company.
- The provisional comment bringing out incorrect valuation of the inventories having material impact of true and fair view of the working of the company.
- The provisional comment on unrealistic accounting of interest income, the principal amount of which is doubtful of recovery.

- The provisional comment on pointing out the lapses of treating the specific/confirm liabilities as 'contingent liabilities.
- The provisional comments highlighting accounting lapses such as instead of providing for known liabilities/income, disclosure is made in the note on accounts.
- The provisional comments bringing out the inconsistencies in the accounting of various claims.
- The provisional comments highlighting the non-compliance of Accounting standards, provision of the Companies Act, 2013 instructions, orders, of the Government/Regulatory bodies etc.

The above list is only illustrative and MAB may propose comment despite assurance, in any other cases also that they feel justified.

4.12.6. Assurance may be accepted on reasonable basis for dropping provisional comments under the following circumstances: -

- The provisional comment bringing out the classification mistakes under the same head of accounts.
- The provisional comments relating to disclosure aspect not covered under the provisions of accounting standards/ Schedule III of the Companies Act, 2013 etc. as well as not affecting the true and fair view of the financial statement.

4.12.7. With a view to ensure that corrective action has been taken by the management on the points dropped based on 'assurances' a brief write up whether the management has set right the mistake or the same is still persisting should be given to headquarters. Further, brief summary of the provisional comments dropped by MAB office should be supplied to the headquarters office.

4.13. Procedure to be followed for issue of Nil Comments Certificate after issuing provisional comments

4.13.1. Nil comments certificate on standalone/ consolidated financial statements of Maharatna, Navratna, Miniratna (Category-I &II) CPSEs under section 143 (6) (b) of the Companies Act, 2013 shall be issued by field offices only after obtaining the approval of Headquarters.

4.13.2. The field office may forward to Headquarters an annotated statement containing all provisional comments, management and statutory auditor's reply thereto and further remarks of the field office for dropping the same in case of Maharatna, Navratna, Miniratna (Category-I &II) CPSEs.

4.13.3. The proposal for should reach Headquarters by 45th day from the date of receipt of financial statements of Maharatna, Navratna, Miniratna (Category-I &II) CPSEs at field offices.

(Headquarters Letter No. 207-CA-IV/16-2021 dated 05.07.2021)

4.14. Seeking approval of the CAG's Office for Draft Comments

4.14.1 Where, after examination of the replies received for provisional comments, it is ultimately decided to pursue them further, approval of the CAG's Office is required to be obtained by forwarding draft comments to Headquarters office.

4.14.2. The proposal for draft comments should reach Headquarters by 45th day from the date of receipt of financial statements of Maharatna, Navratna, Miniratna (Category-I &II) CPSEs at field offices.

The field office may forward to Headquarters an annotated statement containing all provisional comments, management and statutory auditor's reply thereto and further remarks of the field office for proposing the provisional comment as a draft comment in case of Maharatna, Navratna, Miniratna (Category-I &II) CPSEs.

(Headquarters Letter No. 207-CA-IV/16-2021 dated 05.07.2021)

The draft comments are to be accompanied by copies of the audit observations issued to the management at various stages and the replies obtained and copies of all the necessary primary key documents used for arriving at the audit conclusions. While forwarding the draft comments to CAG's office it should clearly be stated

- (a) Whether it is being proposed to issue any Management letter to the PSUs with a copy to statutory Auditors as per the instructions issued;
- (b) Whether it is being proposed to issue a letter/memo to the statutory auditors;
- (c) Whether the supplementary audit is conducted in accordance with the audit procedure/checks envisaged in the Title sheet prescribed for audit of accounts of PSUs.

If the draft comments are approved by the CAG's Office, they are to be included in the audit certificate to be issued to the company. If the draft comments are not approved, further course of action is to be decided on the basis of directions received from the CAG's Office.

4.14.3. To observe uniformity in the submission of documents to DAI (Defence) for approval of Draft Comments along with Accounts may be submitted in the following format:

- Draft Comments
- Aide Memoire
- Statement showing classification of comments
- Information in terms of Comptroller & Auditor General of India's letter No 228-CA-II/113-78 dated 27.02.1980
- Proforma on the Performance of Auditors of Government Companies and Corporation for the year.
- A short write up on the company's financial and operating performance.
- Independent Auditor's Report: The opinion given by Independent Auditor should be verified including:
 - Report on other legal and regulatory requirements
 - Report on Internal Financial Control.

The accompaniments of the Annual Accounts i.e. Draft comments along with the above statements including Aide Memoire must be signed and also soft copy in word document are to be forwarded to Headquarters for further processing. The soft copies of Draft comments and Aide Memoire must be in 'Arial' font with size 14 and line spacing of 1.5. The documents should be forwarded to Headquarters strictly as per the above check list.

(Authority: CAG UO No. 584/D&C/Misc/163/2017 dated 21.12.2018)

4.15. Issue of audit certificate

4.15.1. Where it has been decided not to conduct supplementary audit of the accounts of a Company for any year, a non-review certificate in the prescribed form is to be issued to the Company.

(Circular No. 61/CA-IV/38-2006/Vol II dt 08.08.2018, No. CA-IV/38-2006/Vol. II dated 11.03.2002).

4.15.2. Wherein supplementary audit of accounts of a company for any year is carried out, audit certificate in appropriate form is to be issued to the Company as under:

- (a) Where there are no comments to be included qualifying the certificate of the statutory auditors;
- (b) Where there are no comments to be included qualifying the certificate of the statutory auditors in view of the revision of the accounts/ Independent Auditors' Report on the basis of the audit observations.
- (c) Where there are comments to be included qualifying the certificate of the statutory auditors despite revision of the accounts on the basis of the audit observations; the comments are to be arranged in the specified order;
- (d) Where there are comments to be included qualifying the certificate of the statutory auditors in cases where no revision of the accounts is made by the company on the basis of the audit observations; the comments are to be arranged in the specified order;

4.15.3. While forwarding the audit certificate to the company, it should be requested to ensure that the comments are -

- Printed in toto without any editing;
- Placed next to the statutory auditors' report in the Annual Report of the company with proper indication in the index; and
- Placed before the Annual General Meeting as required under Section 143(6) (b) of the Companies Act, 2013.

4.15.4. A copy of the audit certificate as issued to the company is required to be endorsed to the CAG's Office along with the following documents:

- (a) Compliance certificate by PDCA in the prescribed form.
- (b) *pro forma* on the performance of auditors of Government companies and corporations; and
- (c) Annexure A indicating the details of provisional comments dropped by MAB and their monetary value.

4.16. Issue of Management Letter

4.16.1. As a standard practice, in case of companies selected for supplementary audit, apart from issue of an audit certificate in cases covered by paragraph 6.14.2, an exhaustive list of all important matters which have not been highlighted by statutory auditors and which were not considered material for the CAG's formal supplementary audit comment is to be brought to the notice of the management through a Management Letter under the signature of PDCA. The matters on which the company has given assurances of action in the future are also to be included in the letter. The company is to be requested to place the Management Letter before the Audit Committee (where in existence) of the Board of Directors at its meeting held immediately after receipt of the letter for its appropriate directions.

4.16.2. A copy of the Management Letter as issued to companies is also to be sent to the statutory auditors seeking their clarification for not pointing out the same either in their formal audit report under Standard on Auditing 700 or in their letter to the Audit Committee/Board under Standard on Auditing 260.

4.17. Value addition by Audit

Apart from the draft comments emanating as a result of financial audit, the value addition by Audit representing accounting adjustments, corrective action taken by the management at the instance of audit observations made by CAG audit teams during audit and impact of such adjustment/corrective action on assets/liabilities and/or profitability, changes in the accounting policies, notes to accounts may be reported to CAG's office duly confirmed by management and duly supported by documents for inclusion in CAG's report.

4.18. No power of direction with the executive in relation to Audit

It is important for the independence of the Comptroller and Auditor General that there is no power of direction by the executive in relation to the performance of the audit mandate. The Comptroller and Auditor General is not obliged to carry out, modify or refrain from carrying out an audit or suppress or modify audit findings, conclusions and recommendations in the light of any directions by the executive.

This, however, does not preclude requests to the Comptroller and Auditor General by the executive proposing matters for audit. Decision in this regard shall rest finally with the Comptroller and Auditor General.

(9 of Audit Regulations 2020).

4.19. Reopening/revision of annual accounts after their adoption in the annual general meeting

Government of India, Ministry of Finance and Company Affairs, Department of Company Affairs has clarified that a company could reopen and revise its accounts even after their adoption in the annual general meeting and filing with the Registrar of Companies in order to comply with technical requirements of any other law to achieve the objective of exhibiting true and fair view. It has also stated that the revised annual accounts would be required to be adopted either in the extraordinary general meeting or in the subsequent annual general meeting and filed with the Registrar of Companies.

CHAPTER 5 COMPLAINT AUDIT

5.1. Audit Mandate for Compliance Audit

The audit mandate of IA&AD is derived from the Articles 149 & 151 of the Constitution of India. Article 149 of the Constitution of India envisages that CAG shall perform such duties and exercise such powers in relation to the accounts of the Union, of the States and of any authority or body as may be prescribed by or under any law made by Parliament. Article 151 of the Constitution of India provides that the reports of the CAG of India relating to the accounts of the Union or a State government shall be submitted to the President or the Governor of the State respectively, who shall cause them to be laid before each House of Parliament/ Legislature of the States. The statutory position is established under the CAG's (Duties, Powers and Conditions of Service), Act 1971. CAG's Regulations on Audit and Accounts, 2007 provides appropriate guidance on the various audits undertaken by IA & AD and Chapter 6 of the CAG's Regulations on Audit and Accounts, 2007 contains specific guidance on compliance audit.

5.2. Compliance Audit Objectives

5.2.1. The examination of transactions relating to expenditure, receipts, assets and liabilities of a company with reference to the Constitution of India and the applicable laws as also the rules, regulations, orders and instructions issued in pursuance of the provisions thereof is referred to as compliance audit or transaction audit. This includes examination of the rules, regulations, orders and instructions for their legality, adequacy, transparency, propriety and prudence and effectiveness, i.e., whether these are:

- (i) *intra vires* the provisions of the Constitution of India and the laws (legality);
- (ii) sufficiently comprehensive and ensure effective control over receipts, expenditure, assets and liabilities with safeguards against loss due to waste, misuse, mismanagement, errors, frauds and other irregularities (adequacy);
- (iii) clear and free from ambiguity and promote observance of probity in decision making (transparency); and
- (iv) judicious and wise (propriety and prudence); and effective and achieve the intended objectives and aims (effectiveness).

5.2.2. The objective of compliance auditing is to enable the CAG to assess whether the activities of public-sector entities are in accordance with the authorities governing those entities. Compliance audits are carried out by assessing whether activities, financial transactions and information comply, in all material respects, with the authorities, which govern the auditable entity. It is concerned with regularity and propriety audit.

Regularity – that the subject matter of the audit adheres to formal criteria emanating from the relevant laws, regulations and agreements which are applicable to the auditable entity.

Propriety – that general principles of sound public sector financial management and ethical conduct have been adhered to, legality and competence are ensured. (Compliance Auditing Guidelines)

Further, the auditor should also ensure that audit team has conducted audit in accordance with SA 200 and other relevant standards on auditing.

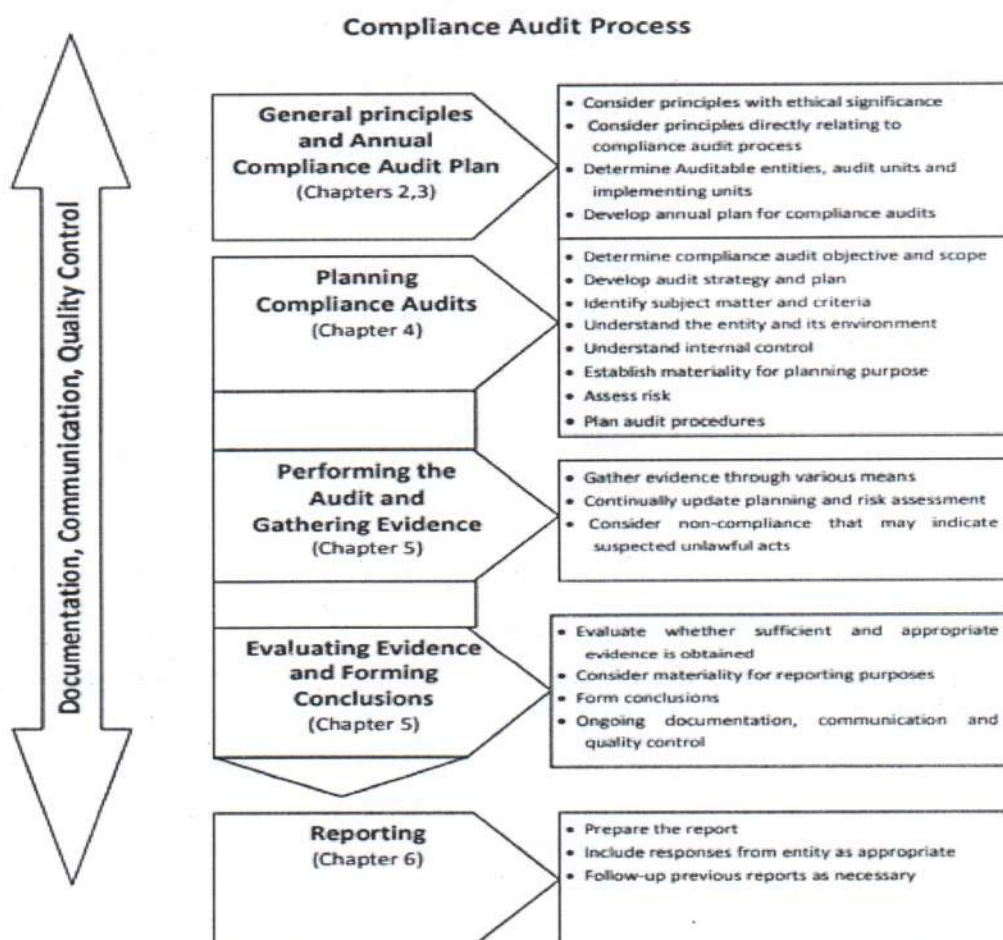
5.2.3. Compliance audits, besides reporting on individual cases of non-compliance and abuse, also require reporting on weaknesses that exist in systems of financial management and internal control. The auditor should also report the results of examination of rules, regulations, orders and instructions and their consistency as well as significant irregularities and instances of fraud and corruption.

5.2.4. This audit also examines transactions for their consistency and highlights cases of persistent and pervasive irregularities suggesting a need to reform or remedy the systems. A detailed examination of the existing organisational structure, procedures and other records helps to assess the possibility of factors which provide opportunities for frauds, malpractices and corruption and identify the cases, if any. Assessment of the quality of internal controls would help to decide the audit objectives.

5.3. Compliance Audit Guidelines, 2016

The Compliance Auditing Guidelines 2016 outlines the principles, objectives, approach, methodology, techniques and procedures for conducting compliance audit. Detailed instructions for audit of the transactions are contained in the Manual of Standing Orders (Audit).

The Compliance Audit Process as explained in Compliance Audit Guidelines, 2016 issued by CAG of India is given below:



5.4. Compliance Audit planning

Compliance Audit planning requires top down, risk based, Department centric mechanism for macro level planning and conducting compliance audits and preparation of annual compliance audit plans by (a) defining the apex auditable entities and audit units and (b) risk profiling. This exercise can provide a holistic view of functioning of the auditable entities without the risk of dismissing audit findings as a random view and statistically insignificant.

The steps in relation to compliance audit planning are explained below:

5.4.1. Classification of DPSUs based on their size and scale of operations

Presently, DPSUs are classified based on their turnover in the following four categories.

Sl. No.	Category	Description
(i)	Very large	Navratna and 'public interest entities' ³ having annual turnover of more than Rs. 1000 crore
(ii)	Large	Public interest entities having annual turnover of less than Rs. 1000 crore and more than Rs. 100 crore
(iii)	Small and medium	Companies with turnover of less than Rs. 100 crore and more than Rs. 5 crore
(iv)	Others	Defunct or companies with turnover of less than Rs. 5 crore

5.4.2. Understanding the business activities of DPSUs and associated risks

The process of understanding the functioning of DPSUs and their activities involves the following:

- Familiarizing with DPSUs and their activities by review of their annual reports, websites, administrative reports, annual reports of MoD, media reports and previous audit reports including those of the statutory auditors and internal auditors;
- If appropriate, a visit to the actual operations may be conducted to become familiar with the activities, risks and controls to identify areas for emphasis;
- Budget information, operating results and financial information of the activities;
- Objectives and goals of the activities;
- MIS reports;
- Review of the policies, plans, procedures, laws, regulations;
- contracts that could have significant impact on operations and reports;
- Organizational structure including job description and segregation of duties;
- Audit Report of the Statutory Auditors including Report under CARO 2020;
- Report of the statutory auditors under Section 143(5) of the Companies Act, 2013;
- Report of the Internal auditors;
- Correspondence files with the Ministry/department;
- Agenda and Minutes of the Board and other committee of Management;

³ Companies whose equity or debt securities are listed or are in the process of listing on any stock exchange, whether in India or outside India, or which is a bank, financial institutions or an insurance entity; or whose turnover exceeds Rs. 100 crore in immediately preceding accounting year; or which has public deposit and/or borrowing from banks and financial institutions in excess of Rs.5.00 crore at any time during the immediately preceding accounting year or which is a holding or a subsidiary of any entity which covered above.

- Authoritative technical literature appropriate to the activities;
- Special reports, if any, on their functioning.

Apart from the above, (a) the Performance against Memorandum of Understanding (MoU) entered into with MoD; (b) Strengths, Weaknesses, Opportunities and Threats (SWOT analysis) assessed by DPSUs themselves; and (c) any other information, document or records that are relevant may also need to be considered.

5.4.3. Selection of units of DPSUs to be audited

A top down and risk based approach to identification of audit units intends to place the Department/Sector as the centre piece of the audit focus and provide a scientific mechanism of defining audit units. The DPSU being the top layer would be defined as the Apex Auditable Entity. Any Division/ Unit/ Branch of the DPSU will be defined as an Audit Unit, if it has one or more of the following attributes:

- substantial devolution of administrative and financial powers;
- functional autonomy; and
- operational significance with reference to achievement of objectives of the apex

The office is maintaining the list of all the Apex Auditable Units and audit units (**Annexure III**). The selection of units should be based on risk assessment for which detailed procedure is given in Hqrs letter mentioned at 5.4.4. above. The office ensures coverage of all Audit units in a reasonable period of time, between three to five years.

The procedure that should be followed while planning compliance audits includes carrying out of Data Analytics, involving mapping (identify) of the relevant audited entity databases and third party databases if any, collecting databases and analyzing it as per data analytic guidelines (under preparation by Headquarters). The analysis should be utilized as inputs for audit plan. The activities are primarily one time exercise requiring periodic updating.

(Guidance Note No. 206/-09-PPG/2017 dated 23 August 2017)

5.4.4. Allocation of audit resources based on scale of operations and business risk

After identification of themes/activities, selection of themes/activities, selection of units to be audited, resources are to be allocated to the themes as under:

Particulars		Party days
Total number of party days		A
Less Party days for		
(i) Administration, Report coordination, etc.	x	B = (x+y+z)
(ii) Certification audit	y	
(iii) Performance audit	z	
Less Party days required for small and medium and other DPSUs		C
Party days available for Compliance Audit		D=A-B-C

Thereafter, party days for each Compliance Audit may be allocated based on assessed volume of work.

5.4.5. A compliance audit has to be planned in a manner which ensures that a high quality audit is carried out in an economic, efficient and effective way and in a timely manner. Adequate planning will ensure that appropriate attention is accorded to crucial areas of audit and that potential problems are identified in a timely manner.

5.4.6. After the preparation of the annual Compliance Audit Plan as discussed in Chapter 3, the process of planning for individual compliance audits commences. Planning for individual compliance audits includes preparing the audit strategy and an audit plan.

5.4.7. Preparation of audit strategy for the identified audit entity would include:

- An understanding of the auditable entity and its internal control environment, including the statutory, regulatory and legal framework applicable to the auditable entity and the applicable rules, regulations, policies, codes, significant contracts or agreements etc;
- An understanding of relevant principles of sound public sector financial management and expectations regarding the conduct of public sector officials for propriety related issues;
- Identification of the intended users, including responsible party and those charged with governance;
- Consideration of materiality and risk assessment including suspected unlawful acts or fraud;
- Determining the scope of audit with reference to the selected specific subject matter, if selected, as well as proprietary concerns;
- Development of audit objectives for the specific subject matter, if selected;
- Identification of audit criteria for specific subject matter;
- Sampling considerations, specifically for implementing units below the selected audit units; and
- Considerations related to direction, supervision and review of the audit team(s).

5.4.8. Once the audit strategy is in place, the audit plan could be prepared. The plan for the identified apex auditable entity would include:

- Description of selected audit units Sample selection of implementing units under the selected audit units;
- Extent of audit in each selected unit;
- Timing of audit;
- Formation of audit team/s (in case more than one audit team is needed for the auditable entity);
- Assignment plan detailing the duties of the audit team members;
- Planned audit procedures; and
- Potential audit evidence to be collected during the audit

Both the overall audit strategy and the audit plan should be documented in the audit file.

5.4.9. Planning audit procedures

After determination of the scope of audit, development of audit objectives, identification of relevant criteria for measuring the selected subject matters, when specifically select for an apex auditable entity or across auditable entities, both for regularity and propriety issues, auditors should prepare a Compliance audit design matrix for the identified apex auditable entity in the following format:

Compliance Audit Design Matrix Audit objective/Sub objective	Audit questions on selected subject matters	Audit criteria	Data collection and analysis method	Audit evidence
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(Para 4.17 of Compliance Auditing Guidelines, 2016)

5.4.10. Advance intimation for Audit

The audit office shall give sufficient advance intimation to the Officer in charge of the Office to be audited. Audit offices may even give advance intimation to the auditable entities as soon as their audit plan is approved. The intimation for audit shall state the likely duration of audit including duration of visit to auditable entity, audit scope and objectives, and composition of the audit team. In cases where the audit involves an element of surprise check, no advance intimation need be given.

(Para 130 of the Regulations on Audit and Accounts, 2020)

As soon as the Quarterly Audit Programme is approved, the Section concerned in the Main Office should send an intimation of the proposed audit to the management of the company over the signature of the Group Officer and where necessary, with copy to the unit. The format for issue of the intimation as communicated by HQ vid letter No.322/CA IV/25-2005 dated 25 July 2008.

5.5. Conduct of Compliance Audit

5.5.1. Providing records to audit party conducting the audit

Before the audit parties assigned with audit of a particular unit commence their work, the Section concerned in the Main Office should provide the following records to the audit parties:

- Forwarding docket (A covering letter indicating the records provided to the Audit Party for undertaking the audit)
- Audit Note Book
- Register of important points requiring local verification
- Previous inspection reports outstanding together with replies requiring further verification
- Results of review of proceedings of the Board and its committees as may be relevant.

5.5.2. In terms of Para 3.24 of the Compliance Auditing Guidelines 2016, it is the duty of the Auditor to ensure that policies and procedures have been put in place to safeguard independence, objectivity and impartiality. To this end, prior to commencement of an auditing assignment, all members of the audit party, including the supervising Group Officer, should give individual undertakings in the below format.

Declaration regarding adherence to the Code of Ethics of the Comptroller and Auditor General of India

(This declaration is required to be signed separately by each member of the audit team prior to the commencement of the audit. A copy of the declaration should be given to the head of the audited entity as soon as the audit commences. Each declaration should be enclosed in original with the Inspection Report).

I, Shri/Smt/Kum _____ (name), _____ (designation) hereby declare that:

- I have read and understood the SAI India's Code of Ethics.
- I will uphold and abide by the SAI India's Code of Ethics and the CCS (Conduct) Rules.
- I do not have any personal or professional interest in the audited entity. As a representative of the SAI India, I undertake to adhere to the following:
- I will conduct the audit assigned to me in a fair, honest, timely and competent manner.
- I will maintain strict confidentiality of all information gathered in the course of audit.
- I will not behave or conduct myself in an inappropriate manner with any official of the audited entity.
- I will not accept any kind of inducement prohibited under the Central Civil Services (Conduct) Rules, 1964, directly or indirectly from the audited entity.

Signed: _____

Date: _____

Auditors should protect their independence and avoid any possible conflict of interest by refusing gifts or gratuities which could influence or be perceived as influencing Code of Ethics for the IAAD of their independence and integrity.

5.5.3. Entry meeting

Audit team should hold entry meeting(s) with heads of audit units before commencement of audit. During these meeting the audit team should explain the purpose, objective of audit, timelines and co-operation expected from the head of audit unit.

(para 5.21 of the Compliance Auditing Guidelines, 2016)

5.5.4. Contract Audit Checklist

5.5.3.1. Based on the meeting held on 19 and 20 January 2015 CAG has given a checklist of contract audit (vide email dated 11.06.2015) which should be observed by inspecting officer during compliance audit. This checklist is prepared as an assurance mechanism to ensure that the due diligence has been exercised by the audit team during audit of contracts.

5.5.3.2. This checklist consists of three parts viz., Selection of sample of contract for audit, documentation and checklist. The high value contracts with customers and procurement orders on vendors immediately after signing are subjected to audit in the subsequent compliance audit. The contracts are reviewed from bid stage till completion of execution of the order.

Illustrated areas that are subjected to audit scrutiny as follows:-

- (i) Excessive, fraudulent and infructuous purchases made without taking into consideration available stocks, outstanding dues / supplies, past consumption pattern and average life of the equipments / items resulting in idle stock with no residual life and incurrence of extra expenditure on the inventory carrying cost.
- (ii) Working out the estimated rates by extrapolating the price of the lowest capacity equipment or by applying a uniform yearly compounded escalation over the prices of similar equipment purchased earlier
- (iii) Adoption of limited tender inquiry to select vendors resulting in lack of competition or favoritism to select vendors

- (iv) Not giving wide publicity for global tender enquiries and sufficient time for bidders for submitting quotes.
- (v) Ambiguity in financial terms and conditions and technical specifications in the bid document
- (vi) Evaluation of the bidders with respect to important terms like payment term, Delivery period, Performance Bank Guarantee etc.,
- (vii) Distribution of quantity order in a fair, transparent and equitable manner
- (viii) Establishment of reasonableness of the prices on the basis of estimated rates, prevailing market rates, last purchase prices, economic indices of the raw material/ labor, other input costs and intrinsic value etc., before award of the Contract.
- (ix) Payment of Advance after getting an acceptable Bank Guarantee for an equivalent amount with sufficient validity
- (x) Submission of Performance Bank Guarantee by the vendors with validity up to Warranty period for due performance of the Contract
- (xi) Incorporation of specific delivery period for supply as per the terms of delivery such as FOR station of dispatch/ destination and for completion of installation with the necessary revision for Liquidated Damages/ penalty clause in the event of delay in supplies/ installation in the Contract
- (xii) Incorporation of detailed guarantee/ warranty clause embodying all the safeguards in the tender enquiry and the Contract
- (xiii) Supply of specific makes/ models of an equipment as specified in the tender/ Contract by the vendors
- (xiv) Amendment/ relaxation in Contractual terms favorable to the supplier
- (xv) Time/ cost over-runs due to lack of co-ordination and diversified approaches followed by various agencies
- (xvi) Absence of/ ambiguity in Contractual clause relating to Liquidated Damages
- (xvii) Extension of delivery period in a routine and casual manner

(Appendix - IX of Part I of Defence Audit Manual – Page 228 to 241)

5.5.5. Issue of audit requisitions/memos

All audit memos, other than those requiring supply of documents and records, shall be issued over the signature of the inspecting officer or carry an indication of his approval. The audit memos should carry serial number and date of issue. In order to facilitate audit parties to have certain statistical information, Office should call for from the companies, data in the specified formats which should be incorporated by the audit parties in Part I of the draft inspection report. If audit observations flow from the analysis, the observations should be included along with the statistical data in Part II A or Part II B of the draft inspection report as appropriate.

5.5.6. Preparation of draft inspection report

The responsibility of drafting the Inspection report shall vest with respective audit team and that of review and approval with respective Group Officer in field offices. The Inspection

Report of an audit unit should provide a perspective of the unit level compliance and may comprise the following parts:

Part I – Introduction - This part may commence with an overview of the audit unit and may provide its functional/geographical jurisdiction, budget, financial performance and a perspective of the relative significance of the unit in the overall hierarchy of the department in pursuit of organisational goals. This may be followed by a brief explanation of the scope of audit, the sampling procedure followed and the audit sample – including the implementing units, the subject matter(s) selected and the sources of criteria that have been adopted to evaluate the selected subject matter(s). It may indicate that audit has been conducted in accordance with the applicable Auditing Standards of CAG.

Part II – Audit findings – This part shall contain all findings – both positive and negative findings that pertain to the audit unit and may be arranged in two distinct parts - Part IIA and IIB - the first part comprising significant audit findings relating to evaluation of the regularity related subject matter(s)/ specific subject matter(s) and propriety related subject matters and the second part – IIB comprising other incidental findings relating to both regularity and propriety aspects. The audit findings should be organised in decreasing order of materiality and significance, if possible. Presentation of audit findings shall conform to the Auditing Standards and other reporting principles enunciated in this chapter and clearly bring out the applied criteria, the results of evaluation of the subject matter against the criteria highlighting the cause and effect relationship. Audit findings may also appropriately indicate the extent of non-compliance and whether they involve systemic issues or represent isolated cases of non-compliance.

Part III – Follow up on findings outstanding from previous reports–This part may indicate the progress of settlement of audit findings outstanding from previous Inspection Reports and list out the findings that continue to be outstanding.

Part IV– Best practices – Any good practices or innovations, if noticed, during the course of audit may be mentioned.

Part V – Acknowledgement– This part may contain the acknowledgement of the extent of audit units' cooperation in all matters including production of records called for in Audit. It may also contain details of persons holding the leadership positions in the audit units.

The responsibility of drafting the Inspection Reports shall vest with the respective audit team and that of review and approval with the respective Group Officer in field offices.

The broad structure of the draft inspection report should generally be arranged under the following categories in terms of letter No. Co-ord/2008-09/239 dated 2 December 2008.

- Fraud, misappropriation, embezzlement, etc.
- Infertuous expenditure
- Lax enforcement of contractual obligation in purchases
- Unauthorized expenditure
- Blockage of funds and injudicious purchases
- Non-utilisation of resources provided/allocated.

Where there are no observations under any category, the fact should be indicated as such.

5.5.7. Exit meeting

The inspecting officer and the officer in charge of the audited entity should discuss the draft inspection report at the close of the audit. The Inspecting Officer may request responses on the observations contained in the draft IR. The officer in charge should confirm the facts and

figures included in the draft inspection report and any point of disagreement should be resolved. The officer in charge should also offer his observations on the audit conclusions and recommendations, if any. A written record of the proceedings of the meeting duly signed by both the parties shall be kept.

5.5.8. Audit Findings Matrix

Auditors are encouraged to prepare an Audit Findings matrix in the following format including all findings (both positive and negative) while finalizing the audit conclusions:-

Audit Findings Matrix				
Audit objective /Sub objective	Audit questions on selected subject matters	Criteria	Audit Evidence	Conclusions

(Para 5.14 of Compliance Audit Guidelines, 2016)

5.5.9. Dispatch of draft inspection report to the Main Office

The finalised draft inspection report should be sent by the inspecting officer to the Main Office within 7 days of the last day of audit along with the following documents:

- List of audit requisitions issued with acknowledgement of the recipient;
- List of audit memos issued with acknowledgement of the recipient;
- Details of sample selection made along with technique adopted in respect of each type of transaction wherever applied;
- Statement of distribution of work among members of the audit team with their names, designation and initials;
- Nature of irregularity noticed and relevant key documents;
- Register of important pointed marked for local verification after recording the results of the verification made during the current audit;
- Audit Note Book with updated information;
- Format for planning audit procedures;
- Title Sheet;
- Review note on purchase orders, sanctions and contracts in the prescribed format;
- Authenticated record note/minutes of entry meeting;
- Authenticated record note/minutes of discussions of the draft inspection report with the officer in charge of the audited entity;
- Certificate on Code of ethics by each members of the team;
- Matrix for grading the Inspection Reports;
- Review remarks on agenda and minutes of Board of Directors and Audit committees;
- Verification remarks of outstanding paras of previous Inspection Reports.

The extent of audit prescribed is to be deviated, prior approval of the Main Office is required. A copy of the approval so obtained may be sent along with the draft Inspection Report.

In respect of observations in the draft inspection report which have the potential of being developed into paragraphs for the CAG's Audit Reports, they should be accompanied by all necessary key documents in support of facts and figures (where required with detailed calculations) alongwith the views of the management.

Besides, soft copy of the draft inspection report should also be provided to the Main Office to avoid repetitive typing and facilitating speedier corrections/modifications.

5.6. Vetting and issue of draft inspection report in the Main Office

The CAG's Office has prescribed a time limit of one month after the last day of audit for issue of approved inspection reports to the management. Considering that seven days are provided to the audit parties to forward the draft inspection reports to the Main Office, the approved inspection reports are to be issued to audited entity with copy to the controlling authority within 23 days. To ensure that this is complied with, the concerned section in the Main Office should submit them to the Group Officer concerned within seven days. This will give adequate time for the Group Officer to examine the contents of the report and make value addition before according approval. After approval, the process of typing of the report and its issue to the audited entity with a copy to the controlling authority should be completed within the remaining days allowing four weeks for furnishing the first reply.

5.7. Appreciation Note

A Departmental Appreciation Note may be issued to the Apex Auditable Entity (DPSUs) where a specific subject matter has been selected to assess the extent of compliance from a departmental perspective or the Principal Director intends to draw attention of the executive towards system weaknesses etc. A consolidation of audit findings presented through the Departmental Appreciation Note would enable appreciation of both the audit findings that form the basis for Auditor's conclusion on compliance by DPSUs as well as the audit findings that would feature as standalone findings. The Departmental Appreciation Note shall be issued to the Head of the DPSUs, for initiating remedial measures with a copy provided for information to the next higher level charged with governance and to Headquarters Office.

(Para 6.7 of Compliance Audit Guidelines, 2016)

5.8. Improving the quality of inspection reports

C&AG has issued guidance note (No. 226-09-PPG/2017) on 'Improving the quality of inspection reports'. The guideline is intended towards establishing the specific procedure that should be followed while planning, conducting and reporting the results of Compliance audit through Inspection Reports. The same should be followed by field office and audit parties during planning, conducting, reporting and follow up of compliance audit.

5.9. Identification of Potential Draft Paragraphs and their pursuance to the level of Draft Paragraphs

The Title Sheet furnished by the Audit Parties contains details of observations which have been regarded by them as having the potential for development as Draft Paragraphs. These cases should receive special attention at the time of vetting of the Inspection Reports. In cases of concurrence, entries regarding the paragraphs of the Inspection Reports should be made in a Register of Potential Draft Paragraphs in **Form 4**. The Register should be closed and submitted to the Group Officer by the 10th of every month for review. Continuous watch should be kept on their development and wherever required additional documentary evidence should be collected and cases processed as draft paragraphs without loss of time as the issues might lose their topicality.

As there was a high mortality rates of the paras owing to factors such as lack of due examination of audit evidence and replies of the department and issues relating to relevance, accuracy, topicality and completeness, Headquarters Office felt that efforts may be focused on quality of audit paras rather than quantity and that focusing on auditing outcomes rather than outputs. It had been decided that a top-down approach, may be required to bring down the number of audit paras/ repots to improve quality.

In order to issue quality audit paras to the Ministry of Defence it has been decided that all defence audit field offices should forward draft material duly linked with KDs along with the list of KDs for the Audit Report to Headquarters Office at the initial stage itself for 'Approval In Principle (AIP)'. It has been further decided that if no communication is received from Headquarters Office within one month of receipt of Audit Paras/ Review/ LP/ TA, AIP may be deemed to be received by field offices.

While submitting Draft Paragraphs to Headquarters, following aspects have to be considered:

- Delay should not be the centre piece of any Para, it can only be the part of passing comments. Critical analysis of delays may be done and the story of delay may be divided into such critical issues/steps.
- Criticality of the issue in the larger picture should be evident from the Para. It should be expressed in such a way that importance of the issue for the armed forces, should clearly come in the draft report/executive summary.
- Description of the flow of decisions/steps taken by the auditee authorities may be in the form of pictorial depiction.
- In case of non-production of critical records, we need to hint in our report, the nature of vested interests. Further, a separate DP on absence/non-production of records to audit stating their impacts may be included in the audit report.

[No.230/136/D&C/2017 dated 09.05.2018 ,No.254/136/D&C/2017 dated 29.05.2018 and Hqrs e-mail on Drafting of audit para being submitted to Headquarters dated 21.10.2020]

5.10. Pursuance of inspection reports

As soon as an inspection report is issued, the Section concerned in the Main Office and the Resident Audit Parties should enter, in seriatim, the serial numbers of the paragraphs (Part I, Part IIA and Part IIB) in a Register of Inspection Reports (Form 5) for watching action taken by the Managements. The register should be completed by making entries of the date of issue of the inspection report, due date for receipt of replies, date(s) of first and subsequent replies, results of verification of the replies and date of closure of the paragraphs.

The register should also contain an abstract for each month giving the following details:
Closed for the month of

Particulars	Number of		Sl. nos. of	
	IRs	Paragraphs	IRs	Paragraphs
Opening balance				
IR(s) issued during the month				
Total				
IR(s) settled during the month				
Closing balance				

Further break up of year-wise details of IRs and paragraphs for the closing balance should also be given to facilitate concentration of efforts for settlement of older cases.

The register should be submitted to the Group Officer by 10th of every month duly closed for the previous month.

A quarterly DO letter from the Group Officer to CMD/CEO of each company may also be issued highlighting all the outstanding audit observations (inspection report-wise and unit-wise) giving a gist of the audit observation and stating what action is expected from the Management for settlement of the paragraphs.

5.11. Arrangement of Audit Arrears Committee meetings for settlement of outstanding objections

The responsibility for settlement of audit observations is that of the management of the DPSUs. The CAG's Office has directed that in order to reduce the outstanding paragraphs in the inspection reports, Audit Arrears committee have to be constituted and periodical meetings should be organized with the Managements of the companies.

CHAPTER 6

PERFORMANCE AUDIT

6.1. General

Compliance audit is generally applied to individual transactions. For an assessment of the implementation and results of a plan, project, programme or scheme, or the functioning of an organisation in terms of its goals and objectives, their comprehensive review aimed at ascertaining the extent to which the expected results have been achieved from the use of available resources of money, men and materials, a technique called performance audit is adopted. In this audit, the economy, efficiency and effectiveness of the plans, projects, etc. are assessed and evaluated. In reviewing performance against the outputs and outcomes, Audit may critically review the measurable objectives and performance indicators for their reasonableness and soundness. Audit may also set criteria for reviewing programme performance based on best practices.

Detailed guidelines issued by CAG's office for conducting this type of audit are contained in the Performance Audit Guidelines 2014.

6.2. Mandate for Performance Audit

The audit mandate of the Department is derived from the Constitution of India. Article 151 of the Constitution of India provides that the reports of the Comptroller and Auditor General of India relating to the accounts of the Union or a State government shall be submitted to the President or the Governor of the State respectively, who shall cause them to be laid before each House of Parliament/ Legislature of the State. The statutory position is established under the Comptroller and Auditor General's (Duties, Powers and Conditions of Service), Act 1971. The mandate of C&AG of India for performance audits is described in Sections 13, 14, 15, 16, 17, 19 and 20 read with Section 23 of this Act. Chapter 7 of the Regulations on Audit and Accounts, 2007 provides the specific guidance on this subject. Regulation 68 defines performance audit as an independent assessment or examination of the extent to which an organisation, programme or scheme operates economically, efficiently and effectively.

6.3. Planning Performance Audits

6.3.1. Before implementing the performance audit, it is important to identify the audit objectives, the scope and the methodology to achieve the objectives of a particular performance audit. This is often done in the form of a pilot study. The purpose of this study is to establish whether the conditions for carrying out a performance audit exist and, if they do exist, to produce an audit proposal. It provides background knowledge and information needed to understand the entity, program, or function. At the end of the study, it may be clearly stated whether performance audit is feasible or not. Pilot study should normally be carried out in a fairly short period.

6.3.2. Planning consists of developing guidelines and assessing resources. The audit guidelines should be detailed, including information on the audited entity's environment, audit materiality and risks, and description of the audit scope, objectives and methodology.

6.3.3. The important steps in drawing up an audit proposal are the following:

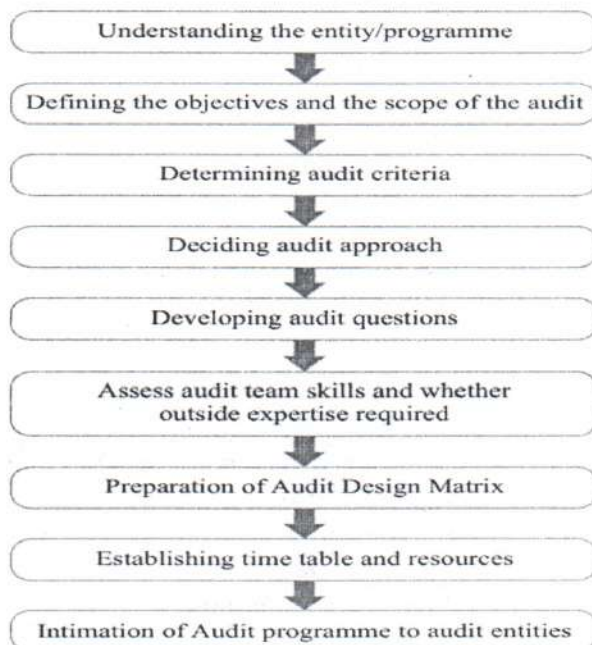
- Defining the specific issue to be studied and the audit objectives;
- Developing the scope and the design of the audit;
- Determining the timetable and the resources.

6.3.4. Audit Design Matrix is a rigorous, structured and highly focused approach to designing a performance audit study, based around the audit objectives, associated sub-objectives and lower level detailed questions. It provides a framework for field work and further analysis. Having determined audit questions that require answers, the performance auditor is also expected to append to the audit design matrix, the procedures to find answers to audit questions. It also highlights the data collection and analysis method as well as the type and sources of evidence required to support audit opinion/ findings with reference to the defined audit objectives. The Audit Design Matrix is to be considered throughout planning, examination and reporting phases to ensure that all identified audit issues are covered. Once the examination phase is over, the audit team should suitably link Audit Design Matrix to the Audit Findings Matrix. The specimen of Audit Design Matrix is given hereunder:

Audit Design Matrix

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

6.3.4. The following chart indicates the process involved in planning an individual performance audit in practice. These steps cannot always be strictly separated and they do not necessarily take place in the same order through.



6.4. Engagement of Consultants

6.4.1. Collectively, the audit team should have the necessary professional competence to perform the audit. This would include in addition to the knowledge of the domain of the audited entity, sound knowledge of auditing, research design, social science methods and investigation or evaluation techniques, as well as personal strengths such as analytical, writing and communication skills.

6.4.2. In specialised areas, external experts can be used to complement the knowledge of the audit team. Auditors should evaluate whether and in what areas external expertise is required, and make the necessary arrangements. The services of a consultant or expert of repute in the relevant field may be useful in developing the criteria, particularly on subjects, that are either new or complex. The procurement of the services of the expert or using their work will be as per the general guidelines approved by the C&AG office from time to time. Unless otherwise decided in particular cases, it is encouraged to share the information with the entity that the criteria are determined in consultation with the institute or expert.

(Para 2.22, 4.19 and 4.36 of Performance Auditing Guidelines)

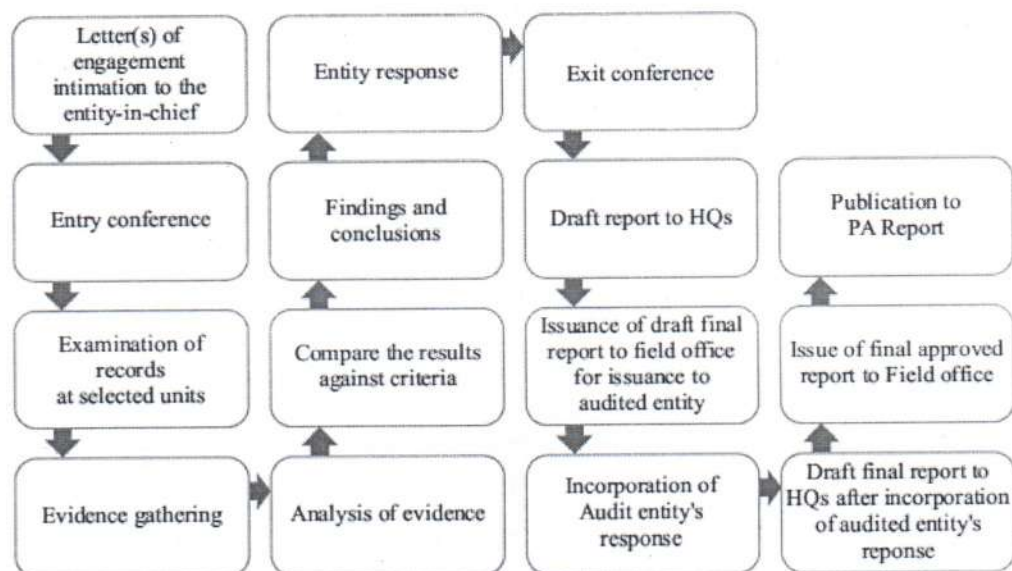
6.5. Interaction with auditable entity during Performance Audit

6.5.1. This audit envisages a high degree of interaction with the auditable entities, right from the selection of subject(s) for review to all subsequent stages like definition of audit objectives and criteria, preparation of detailed audit programme, development of audit findings, formulation of recommendations and other related matters. To start with, an entry conference is to be held with the head of the DPSU to finalise the scope and coverage of audit, audit objectives, criteria and techniques of evidence collection that might be adopted, overall timeframe and tentative time schedule. A request should be made for nomination of a sufficiently senior officer of the auditable entity for co-coordinating with the various departments of the entity and ensuring smooth flow of records and data/information to the audit team. The suggestions made by the auditable entity should be given full consideration. A written record of the proceedings of the entry conference, duly signed by both the parties, should be kept on record.

6.5.2. After the draft performance audit report is ready, the draft report should be issued simultaneously to management, ministry with a copy to CAG's office. Subsequently after receipt of management/Ministry's replies, audit conclusions and recommendations are arrived and discussed in the exit conference held with the auditable entity. Full consideration should be given to the observations and comments of the auditable entity while finalising the draft performance audit report before submission to the CAG's Office for approval. While forwarding the draft report to the CAG's Office, availability of all key documents in total and complete form should be ensured and all the facts and figures in the draft report should be duly marked with the key references. On approval of the report by C&AG office, the draft report is forwarded to this office for confirmation of facts and figures. This office should confirm the same on priority.

6.6. Implementation of Performance Audit

The following diagram depicts the Audit Implementation cycle of Performance Audit.



6.7. Structure of Good performance Audit Report

The performance audit report should preferably be presented as per the following structure:

- **Title:** the subject of the performance audit;
- **Executive summary:** It provides the précis of the main report. The summary should not be very long and should contain only essential information. The major audit findings should be placed in the same sequence as the audit objectives and sub-objectives along with recommendations in brief;
- **Introduction:** It consists of a brief description of the subject of study, information on programme, activity, or institution, its objectives, inputs, implementation structure, expected outputs and outcome, etc. The introduction should be brief, yet sufficient to enable the reader understand the context of the programme;
- **Audit objectives:** They are the pivots of the performance audit, which set out the reason for undertaking the audit. The entire exercise of performance audit is built around the audit objectives. These should, therefore, be stated in simple and clear terms. It is useful to set out the audit objectives and sub objectives within each audit objective in the form of complete statement/question;
- **Scope of audit:** It is defined in terms of the period of the programme covered in audit and segments of the programme audited should be set out precisely;
- **Audit methodology:** It describes methods used for data collection/evidence gathering and testing may be stated in brief. This adds to the acceptability of the audit findings and forms a statement for transparency of the audit procedure;

- **Audit criteria:** to arrive at the audit findings and conclusions with reference to each audit objective and sub-objective which should be stated with appropriate explanations
- Audit findings and conclusions made during an audit with reference to each objective should be stated;
- **Recommendations:** They should be presented along with the conclusions wherever applicable in a box or highlighted print;
- **Acknowledgement:** it may be useful to indicate or acknowledge in brief the co-operation, acceptance of the criteria/findings and recommendations by the entity. In case the co-operation or response was not forthcoming at any stage it may be indicated if it has resulted in any limitation along with its implication and the special efforts made to seek cooperation or response;
- **Glossary of terms:** It is helpful to the reader if explanations are provided in a glossary or easy-to-find footnotes. Glossary should be comprehensive, explaining all technical and uncommon terms used in the report.

As part of Integrated Audit Approach, Audit is obtaining end user feedback while reviewing the Projects/ Contracts so as to ensure the satisfaction of the customer and achievement of the specified parameters by DPSUs in executing the Contracts.

6.8. Inclusion of audit paragraphs/reviews in Audit Reports

Head quarter office decided to bring out separate C&AG Audit Report for DPSUs and the CAG Report 19 of 2017 and Report 7 of 2018 were the first and Second Report. During 2019-20 Headquarters Office decided that there may not a separate Audit Report on Defence PSUs in view of the inherent limitations of having a small number of Defence PSUs in this office. Accordingly, Audit paragraphs/reviews in respect of the DPSUs were included in the Audit Reports based on the related activity of each DPSU with the principal arm of the Defence Services. Accordingly, the material relating to HAL was included in Air Force Report, Material for Shipyard in Navy Report and material relating to other companies was included in Army and Ordnance Factories Report.

Name of the PSU	Report in which included
Hindustan Aeronautics Limited	Air force
Indo Russia Helicopter Ltd	
Naini Aerospace Ltd	
Mazagon Dock Limited	Navy
Garden Reach Shipbuilders & Engineers Ltd.,	
Goa Shipyard Ltd.	
Hindustan Shipyard Ltd.	
Bharat Electronics Ltd.	Army
BEML Limited	
BEL Optronics Devices Ltd.	
Mishra Dhatu Nigam Ltd.	
Bharat Dynamics Ltd.	
BEL Thales System	
Vignyan Industries Ltd.	
Defence Innovation Organisation	

6.9. Specific directions of CAG's Office

6.9.1. No audit should commence before the approval of guidelines because such act compromised the integrity of entire process of performance audit. The entry conference should also be done only after the approval of the guidelines so that the Management could be briefed properly about the subject and scope and methodology of audit, sample selection, etc.

6.9.2. Sample for performance audit should be selected in a systematic manner as per accepted sampling methods. Guidelines should clearly spell out the method of sampling also and sample once selected as per guidelines should be frozen and audit conducted as per the sample drawn.

6.9.3 The audit findings, conclusions, and recommendations must be based on evidence. Since auditors seldom have the opportunity to consider all information about the audited entity, it is crucial that the data collection and sampling techniques are carefully chosen. The auditor must make a judgment as to whether sampling is an appropriate way of obtaining some of the audit evidence required.

6.10. Follow up audit

The Performance Auditing Guidelines 2014 provides guidance on the Follow up Audit in a comprehensive manner. Follow up audit refers to a situation where the auditor examines the corrective action taken by the entity on the recommendations of the previous performance audits. While taking up Follow on Audit, it is to be ensured that:

- (i) Performance Audits that have not been selected by PAC/COPU and are not expected to be taken up for examination in near future, should be considered for selection;
- (ii) audit conducted at least three years ago should be considered and
- (iii) such performance audit where the audited entity has accepted the recommendations given by audit.

CHAPTER 7

MATERIAL FOR CAG'S AUDIT REPORTS AND THEIR FOLLOW UP

7.1. General

7.1.1. Section 19A (1) of the CAG's (DPC) Act enjoins the CAG to submit his reports in relation to the accounts of a Government company or corporation referred to in Section 19, to the Government or Governments concerned. The forms, content and time of submission of Audit Reports are decided by the CAG's Office from time to time. The material to be included in the CAG's Audit Reports would include statistical data, comments on annual accounts of companies as a result of supplementary audit, individual paragraphs from compliance audit and observations from performance audit.

7.1.2. Audit Reports are treated as confidential documents till they are placed before the Parliament. Accordingly, all material relating to the Audit Reports are to be treated as strictly confidential right from the stage of issue of preliminary draft paragraphs to Government till the final stage of presentation to Parliament. Adequate care should be taken at every stage to see that the Audit Report material is secured against use by outsiders (the Press, the public or any other outside agencies) till they are presented to Parliament. The draft paragraphs/reviews which are also considered as confidential should be marked invariably as confidential in order to maintain secrecy, while sending them either to the CAG's Office for approval or to the Government for verification of facts or for calling for comments.

7.2. Material for Audit Report No.2 – General Purpose Financial Reports of CPSEs

The Audit Report No.2 contains seven chapters as enumerated below:

7.2.1. The draft Chapter I containing the analysis on the financial performance of CPSEs is prepared by the Member, Audit Board, Chennai on the basis of data provided by each MAB through Summarized Financial Results (SFR). Separate instructions are being issued by that office for uploading SFR on each company.

7.2.2. The draft of Chapter II is prepared by the CAG's Office and would cover 'Oversight role of CAG'. The information relating to the DPSUs under the audit jurisdiction of this office is forwarded to CAG's office.

7.2.3. The draft Chapter III on 'Corporate Governance' in all selected CPSEs is prepared by the Member Audit Board, Chennai on the basis of data and information on all CPSEs. For this purpose, separate instructions are being issued by that office for compilation and furnishing of data and information from each Company.

7.2.4. The draft Chapter IV covers 'Convergence of Indian Accounting Standards with IFRS' and is prepared by CAG's office.

7.2.5. The draft Chapter V covers "Non-compliance with DPE guidelines, Follow up on non-compliance and the directive of Parliamentary Standing Committee on Industry". The information relating to the DPSUs under the audit jurisdiction of this office is being forwarded to CAG's office.

7.2.6. The draft Chapter VI covers 'Corporate Social Responsibility'. The information relating to the DPSUs under the audit jurisdiction of this office is being forwarded to CAG's office.

7.2.7. The draft chapter VII covers any specific issues selected for review for each year.

7.3. Confidentiality of material for Audit Report

Time and again CAG's Office has emphasised the need for strict compliance to the instructions regarding confidentiality of material for Audit Reports. In this context, attention was drawn by CAG's office vide UO dated 19th February 2013 to 'Code of Ethics for IA&AD' which contained the guidelines on integrity and confidentiality/secretcy of the material of the draft audit report.

7.4. Processing of Draft Paragraphs

7.4.1. Important Audit findings noticed during audit may be processed as draft paragraphs and issued to Ministries. CAG's Office has prescribed that only those paragraphs that have money value of RS. 5 crore or more are to be forwarded to the Ministries for their comments. Other paragraphs are to be pursued with the Managements of DPSUs by this office.

7.4.2. Adequate opportunity is to be provided to Government to offer its comments, observations and explanation before including any matter in an Audit Report. A time of six weeks is allowed to the Government for furnishing its comments on each draft paragraph proposed for inclusion in the CAG's Audit Report. Simultaneously, a copy of the draft paragraph duly marking the key references is to be endorsed to CAG's Office for their comments.

7.4.3. Further comprehensive Top sheet is required to be submitted indicating Title of the KD, broad content of the KD, Date and Signatory of KD and page number for all the evidences collected during the course of audit even if it is not directly referenced in the Draft Report

(Hqrs. letter No. DAI(DRL)/Circulars/2018-19/12 dated 18-2-2019)

7.4.4. Consistent with the schedule of preparation, finalisation and presentation of the CAG's Audit Reports as communicated, request for extension of time for sending reply to a draft paragraph may be considered by this office after examining the reasons for seeking extension beyond the time stipulated and that probable date by which the final reply to the draft paragraph would be furnished.

(Para 138 of Audit Regulations, 2020)

If final reply is not received within the specified period or the extended period agreed to, this office may proceed on the assumption that the Company/Government has no comments, observation and explanation in the matter and accordingly finalise the draft paragraph. Where reply is received within the stipulated period or before finalisation of the draft paragraph for inclusion in the Audit Report, this office should give full consideration to it and the draft paragraph may be modified or settled or may not be included in the Audit Report in the light of the reply

7.4.5. The general instructions on the preparation and issue of draft paragraphs are contained in the MSO (Audit), Auditing Standards, Style Guide and Regulations on Audit and Accounts. Series of instructions have been issued by the CAG's Office from time to time for improvement in quality of material proposed for inclusion in the CAG's Audit Reports

regarding choice of material, audit evidence, drafting, and communication of audit comments.

7.4.6. The draft paragraphs should be suitably structured to conform to sequence and logic and ensure smooth narrational flow. The frame work for the draft paragraph issued by CAG's office in January 2013 is as under:

- Preamble – Relevant and applicable rule/guidelines/procedure applicable duly quoting the authority in which contained with date;
- Criteria/reasons for topic selection and amplification of the fact regarding audit focus and for emphasizing relevance and significance of selected subject/area;
- How – When- Where and relevant records examined and through which the findings emanate (including reference to sample selected, if any) to highlight incidence of violation/deficiencies in internal control/persisting irregularity. Nature/name of the records examined and date of audit scrutiny;
- Specific audit findings to be specifically highlighted with clarity (Audit evidence and supporting audit documentation to be available on record, duly authenticated and numbered);
- Issuance of audit findings to designated responsibility centre and management with date of such communication;
- Response/reply thereof;
- Evaluation of reply by Audit and its acceptability/non-acceptability/ inconsistency, etc., as the case may be;
- Issuance to Ministry with date, etc. and evaluation of its reply; and
- Audit conclusion and impact evaluation of the irregularity/violation due to non-observance of rules, etc. referred to in the preamble.

7.4.7. Uniformity in presentation and language of material for Audit Reports

The CAG's Office has prescribed a 'Style Guide' for adopting a uniform approach regarding usage of certain terms, abbreviations, etc. in drafting the material for inclusion in the CAG's Audit Reports. The instructions in the Style Guide are to be adhered to in all cases.

7.5. Follow up of Audit Reports

7.5.1. According to the rules of the Lok Sabha and the Rajya Sabha and conventionally, the CAG's Audit Reports on their presentation in the Parliament stand referred to the Committee on Public Accounts (PAC) and the Committee on Public Undertakings (COPU) for disposal in accordance with the rules of their business.

7.5.2. As soon as information about placement of an Audit Report in Parliament is received, entries should be made in a Register for Watching Receipt and Disposal of Action Taken Notes (ATN) to be maintained in the Section concerned in the Main Office (including for issues concerning Resident Audit Parties) and should be submitted to the Group Officer every month. The rules require submission of Action Taken Notes (ATN) by the Ministry to PAC within the prescribed time limit. The procedure evolved for submission of ATNs requires their vetting by the CAG's Office before consideration by the PAC. The CAG's Office has laid down a time limit of 15 days for submission of vetting remarks by this office on the draft ATNs received from the Ministry (through the CAG's Office). In the case of a Review, the time limit is three weeks for vetting of draft ATNs covering entire or major portion of it. However, presently, while forwarding the ATN, CAG's office prescribes the timeline.

7.5.3. In cases of disagreement between the Ministry and the Audit on the sufficiency of action taken in respect of any of the observations included in the Audit Report, CAG's Office has instructed that after the second journey of the ATN, Audit may forward its remarks on the ATN to the Ministry with a request that the Ministry should forward the audit remarks along with the ATN to COPU and the ATN may not be sent to Audit again. In cases where the irregularity is found to be recurring in the subsequent years' accounts and the amount is material, taking a fresh comment on the subsequent accounts may be a better option for audit instead of insisting upon the corrective action in the ATNs of such audit paras.

CHAPTER 8 COST AUDIT

8.1. General

The Cost Audit (Report) Rules 1996 was amended vide the Cost Audit Report Rules 2001 dated 27 December 2001 and further amended in 2006 and was called the Cost Audit Report (Amendment) Rules, 2006. These Rules shall apply to every company in respect of which an audit of the cost accounting records has been ordered by the Central Government under sub-section (i) of Section 148 of the Companies Act, 2013. After new Companies Act, 2013 a new rule namely Companies (Cost Records and Audit) Rules, 2014 as amended upto 15th July 2016 came into force.

8.1.2. The auditor conducting the cost audit shall comply with the cost auditing standards i.e., such standards as are issued by the Institute of Cost and Works Accountants of India, constituted under the Cost and Works Accountants Act, 1959, with the approval of the Central Government. Audit conducted under this section shall be in addition to the audit conducted under section 143. Notwithstanding anything contained in this Chapter, the Central Government may, by order, in respect of such class of companies engaged in the production of such goods or providing such services as may be prescribed, direct that particulars relating to the utilisation of material or labour or to other items of cost as may be prescribed shall also be included in the books of account kept by that class of companies. If the Central Government is of the opinion, that it is necessary to do so, it may, by order, direct that the audit of cost records of class of companies, which are covered under sub-section (1) and which have a net worth of such amount as may be prescribed or a turnover of such amount as may be prescribed, shall be conducted in the manner specified in the order.

8.1.3. The audit under sub-section (2) shall be conducted by a Cost Accountant in practice who shall be appointed by the Board on such remuneration as may be determined by the members in such manner as may be prescribed. A company shall within thirty days from the date of receipt of a copy of the cost audit report prepared in pursuance of a direction under sub-section (2), furnish the Central Government with such report along with full information and explanation on every reservation or qualification contained therein. If, after considering the cost audit report referred to under this section and the information and explanation furnished by the company under sub-section (6), the Central Government is of the opinion that any further information or explanation is necessary, it may call for such further information and explanation and the company shall furnish the same within such time as may be specified by that Government.

8.1.4. CAG's office had issued instruction to conduct the cost audit. Audit/examination of cost audit information and cost accounting records of DPSUs is an important component of transaction and performance audit. The primary objective of audit would be to verify the maintenance of cost audit records in accordance with the cost accounting record rules framed by Government of India. For this purpose, the audit reports of cost auditor appointed by the Government of India should be critically reviewed especially with reference to the qualification in the audit report and action taken by Management thereon. The cost accounting review by the Audit parties should generally be of the nature of a supplementary or test audit on the financial statements. However, where significant risk and weaknesses have been identified in the costing system, the coverage, scope and extent of audit testing should be suitably expanded especially in case of Projects and manpower costing.

CHAPTER 9

AUDITING IN IT ENVIRONMENT

9.1. General

In view of significant advances in the field of Information Technology (IT), Public Sectors have become increasingly dependent on computerised information systems to conduct their operations and to process, maintain, and report essential information. As a consequence, the reliability of the computerised data and of the systems that process, maintain and report these data is a major concern to audit. IT Auditors evaluate the reliability of computer-generated data supporting financial statements and analyse specific programmes and their outcome. In addition, they examine the adequacy of controls in information systems and related operations to ensure system effectiveness.

IT Audit is the process of collection and evaluation of evidence to determine whether a computer system has been designed to maintain data integrity, safeguard assets, allow the effective realization of organisational goals, and ensure efficient utilisation of resources. Data integrity relates to the accuracy and completeness of information as well as to its validity in accordance with the norms. An effective information system leads the organisation to achieve its objectives and an efficient information system uses minimum resources for this purpose.

9.2. Controls in a computer system

Controls in a computer information system reflect the policies, procedures, practices and organisational structures designed to provide reasonable assurance that the intended objectives will be achieved. They ensure effectiveness and efficiency of operations, reliability of financial reporting and compliance with the rules and regulations.

Information system controls are broadly classified as General Controls and Application controls. General controls include controls over data centre operations, system software acquisition and maintenance, access security and application system development and maintenance. Application controls pertain to specific computer applications.

9.3 Objectives of computer controls

The objectives of controls aim to ensure (i) the provision of effective organisational control over functions related to data processing by clearly defining organisational objectives (ii) effective management control over development of data processing resources in conformity with organisational objectives (iii) adoption of practices related to data processing activities in accordance with statutory requirements and prescribed administrative procedures (iv) adherence to policies, standards and procedures in respect of all data processing functions; and (v) efficiency and effectiveness of the data processing systems geared towards achievement of the desired objectives.

9.4. Preliminary evaluation

The first step in audit should be a preliminary evaluation of the computer systems covering (i) the manner in which the computer function is organised (ii) the use of computer hardware and software (iii) the applications processed by the computer and their relative significance to

the organisation; and (iv) the methods and procedures prescribed for implementation of new applications or revision of existing applications. In the course of the preliminary evaluation, the auditor should ascertain the level of control awareness in the auditee organisation and existence (or non-existence) of control standards.

9.5. Audit methodology

After completing the preliminary evaluation of the computer systems, the auditor has to decide whether it would be more appropriate to adopt the system-based audit approach or the direct substantive testing approach.

9.6. Audit techniques

IT audit techniques refer to the use of computers, including software, as a tool to independently test computer data of interest to Audit. Some of the well-established techniques are (i) collection and processing of a set of test data that reflect all variants of the data and errors which can arise in an application system at different times (ii) use of integrated test facilities, built into the system by the auditee, to assist the auditor in his requirements, as one of the users of the system (iii) simulation of the auditee's application programs using audit software to verify the results of processing (iv) periodical review of programme listings in order to verify that the programme have not been altered unauthorisedly (v) use of either commercial software or programmes developed in-house to interrogate and retrieve data applying selection criteria and to perform calculations and (vi) extraction of data samples from the database/files of the auditee, using sampling techniques, for post analysis and review. The sampling technique to be employed is determined by the nature of data and type of analysis required

(MSO (Audit))

9.7. Audit of accounts in computerised environment

9.7.1. With increase in complexities of Information Systems, traditional audit methods and techniques may not be effective. Therefore there is a need to have Audit Assurance on reliability of IS for conducting audit of annual accounts of an entity. It is therefore desirable that IS/IT Audit of at least financial/accounting systems and associated processes is conducted at all the audit entities which are on ERP/SAP etc., to check whether all business processes are mapped to ensure data integrity including migration of data from legacy system. It is also desirable to activate audit facility available in the information system. It is essential to understand the functioning of the audit entity and inconsistencies and abnormalities, if any, of the information generated through the system and existence of supplementary system or manual controls and to ensure that information presented is accurate and reliable. Comments on deficiencies should be included.

9.7.2. During audit of annual accounts of entities which maintain their accounts on Enterprise Resource Planning (ERP)- a business management software with integrated applications, it is imperative that sample selection and audit are conducted through Computer Assisted Audit Tools (CAAT).

9.7.3. The method and procedure for conducting IS and financial audit will differ from entity to entity and therefore, it is essential to have proper documentation of the audit procedures undertaken by audit and examination of data. This is essential to have an assurance that audit has been conducted as planned and all the material observations i.e. abnormalities and deficiencies have been pointed out. While conducting data analysis it is desirable to ensure

that data is representative. The basis on selection of data and checks exercised needs to be documented.

9.7.4. Total number of Account Codes available, number of new Account Codes introduced, instructions issued during the year for change in accounting of transactions from one accounting code to another, justification for change and system of monitoring the compliance to instructions needs to be verified.

9.8. Audit of Defence PSUs

9.8.1. In DPSUs, where majority of transactions have been computerised, while conducting compliance, certification and performance audit, information available in the system could be utilised to perform basic checks and confirmation. In cases where audit cannot be carried out through the system to the fullest extent, significant verifications can be done through the IT system. For the remaining aspects wherein manual checks were resorted to, system assistance for extracting information could be resorted to.

9.8.2. Illustrative cases where data from the system could be utilised as a tool for audit are as follows:-

Inventory: Details of inventory available in the system could be utilized for all the three types of audit. During certification of accounts audit, classification of inventory (non-moving/slow moving) based on the policy of auditee units, based on the date of movement, the same could be confirmed for appropriate provisions in the accounts. In case of other audits, the system information is useful for analyzing the need for purchases as per requirement and stock position, utilization pattern, selection of project inventory and evaluation, rejection analysis, quality related issues, delay in procurement, obsolescence, shelf life expiry etc.

Purchase process:- In computerized environment, details of Purchase Requisitions, Purchase Order and the other subsequent activities such as payment of advances, if any, receipt of goods, inspection and acceptance, stock movement (accepted goods taken into stock, issue of goods and consumption), would be available in the system. The respective accounting entries during each stage of the activity, stock movement, acceptance of goods and invoice clearances by authorised persons, payments made and process time of each related activity and amendments made by competent authority, etc. can be extracted from system for utilizing during all three types of audit, depending on the scope and requirement. This information assists audit in activity analysis, requirement analysis, purchase price analysis and execution of orders, as well as in sampling and selection for further examination.

Fixed assets:- Fixed assets register from the system could be made use for verification of assessment of requirement, placement of order, receipt, installation/commissioning, capitalization, depreciation, additions and deletions etc.

Execution of customer orders:- Details of customer orders, related procurement, production process, and costing could be extracted from system. These details could be utilized during audit for confirmation of accounting, performance analysis, production process analysis and impact of delays if any, details of materials drawn and utilization of the same for the production, execution of orders.

After utilisation of the information available in the system, additional checks may be resorted to based on the requirements of the audit party.

9.9. Data Analytics

9.9.1. Data analytics is the application of data science approaches to gain insights from data. It involves a sequence of steps starting from collection of data, preparing the data and then applying various data analytic techniques to obtain relevant insights. The insights include, but are not limited to, trends, patterns, deviations, inconsistencies, and relationships among data elements identified through analysis, modeling or visualization, which can be used while planning and conducting audits. Data analytics adds a competitive advantage to enable information based decision making. As it is an evolving discipline, the possible utilities of data analytics are still under experimentation and exploration in both public and private sector.

9.9.2. Guidelines on Data Analytics, 2017 in Indian Audit and Accounts Department (IA&AD) have been approved by C&AG and these guidelines will help in clarifying and institutionalizing the concepts, practice and use of data analytics. The guidelines outline the data analytics, process from data identification, collection, preparation, applying analytic techniques and creation of model to setting up of the data repository. The principles and approaches enunciated in these guidelines will be built upon by additional resources materials. These guidelines prescribe the methodology of employing data analytics in the auditing function of IA&AD. The data analytic principles and methods will, however, be applicable to the domains of accounting and administration. These guidelines have been developed as a follow up of the Big Data Management Policy issued in September 2015 and subsequent initiatives in use of data analytics in IA&AD, particularly in audit.

9.9.3. The guidelines draw on the existing guidelines on Performance Auditing, Compliance Auditing, Financial Auditing, Auditing Standards and other relevant instructions and manuals in IA&AD. Data analytic Group has been formed in field office as a main driver of data analytics. The responsibility of the group included Data analysis for audit planning/conduct of audit, function as a repository of Auditee Data. A Data Analytics Group has been formed in this office in July 2016.

9.9.4. Centre for Data Management and Analytics (CDMA) will play an advisory and supporting role for the overall use of data analytics in IA&AD. CDMA will facilitate through capacity building, collecting third party data at the central level, identifying new software, assessing applicability of different analytic techniques/analytic models and disseminating them in IA&AD. CDMA will provide technical support to the field offices, their data analytic efforts wherever necessary. The Data Analytics models will be vetted and approved by CDMA, in consultation with functional wings of headquarters. The data analytics project is the responsibility of the functional group within the field office. The data analytics group will offer necessary technical assistance to the project.

(No.535/14/Data Analytics Trainings/CDMA/2016-17 dated 20.07.2017 and Guidance Note No.147/2016/629 dated 24.08.2016)

9.10. One IAAD One System

A customized end-to-end IT System for the entire IA&AD (currently called -One IAAD□One System – OIOS) is developed. OIOS includes Audit Process Management System (APMS) and Knowledge Management System (KMS). OIOS will support better and real time monitoring of audit process, especially audit execution. OIOS will also be integrated/ linked with the HR, Training, Budget/ Expenditure monitoring IT systems.

Audit Process Management will be the primary system of record for the entire chain of Audit activities (from audit planning and design through audit execution to issue and follow up of IRs to processing and finalization of Audit Reports and follow up). This will cover all processes – from maintaining the auditee universe, audit planning and design, online preparation of audit requisitions/ audit memos, online preparation and processing of Inspection Reports (including uploading of supporting documentation); follow-up of IRs; processing of Audit Reports; follow-up of IRs/ Audit Reports; processing of ATNs. This will cover all types of Audit – Compliance, financial and performance.

Audit Knowledge Management System (Audit KMS) will include Audit Guidance on Regulations, Standards, Guidelines, and Manuals, Checklists along with Auditee Information / Profile and Inspection Reports for the last five years.

9.11. e-Office

e-Office is a digital workflow-based solution and allows for end-to-end movement of/storage of electronic files. It is a web-based application and can be accessed anywhere on the Internet. e-Office provides flexibility of an open workflow (anybody in the section can send the file to anyone else in the same section) and is a replacement for physical filing system.

During the October 2021 meeting of senior management, the need for making use of e-office mandatory in all field offices agreed and approved by CAG. All field offices are therefore directed to take immediate steps for implementing e-office. The field Offices are to start the implementation of e-office with routine/ administrative activities.

Accordingly, this Office initiated the process of implementation of e-Office and taking the help of IS wing in Headquarters in creating user accounts, conducting training and enabling VPN services for accessing e-office from outside IAAD net.

CHAPTER 10

INTERNAL CONTROL AND INTERNAL AUDIT

10.1. Internal Control

Internal Control is an internal process that is affected by an entity's management & personnel and is designed to provide reasonable assurance that the following objectives are being achieved:-

- Fulfilling accountability obligations;
- Complying with applicable laws and regulations;
- Executing orderly, ethical, economical, efficient & effective operation
- (d) Safeguarding resources against loss.

10.2. Limitations on Internal Control effectiveness

10.2.1. Internal Control cannot by itself ensure the achievement of the general objectives. Internal Control cannot change an inherently poor manager into a good one. Moreover shifts in Government policy or programme, demographic or economic conditions are typically beyond management's control.

10.2.2. An effective system of Internal Control reduces the probability of not achieving the objectives. However, there will always be the risk that internal control will be poorly designed or fail to operate as intended.

10.2.3. Because internal control depends upon human factor, it is subject to flaws in design, errors of judgement or interpretation, misunderstanding, carelessness, fatigue, distraction, collusion, abuse or override. Another limiting factor is that the design of an internal control system faces resource constraints. The benefits of controls must consequently be considered in relation to their costs.

10.3. Components of Internal Control

Internal control consists of five interrelated components:

- Control environment
- Risk assessment
- Control Activities
- Information & communication
- Monitoring

While the internal control framework is relevant and applicable to all organisations, the manner in which management applies it will vary widely with the nature of the entity and depends on a number of entity-specific factors. These factors include the organizational structure, risk profile, operating environment, size, complexity, activities and degree of regulation, among others. As it considers the entity's specific situation, management will make a series of choices regarding the complexity of processes and methodologies deployed to apply the internal control framework components.

10.3.1. Control Environment

The control environment sets the tone of an organisation in influencing the control consciousness of its staff. It is the foundation for all other components of internal control, providing discipline and structure.

10.3.2. Risk Assessment

Risk assessment is the process of identifying & analysing relevant risks to the achievement of the entity's objectives and determining the appropriate response. It implies Risk Identification, Risk evaluation, Assessment of the risk appetite of the organization and Development of responses.

10.3.3. Control Activities

Control activities are the policies and procedures established to address risks and to achieve the entity's objectives. To be effective, control activities must be appropriate, function consistently according to plan throughout the period and be cost effective, comprehensive, reasonable, and directly relate to the control objectives. Control activities occur throughout the organisation, at all levels and in all functions. They include a range of detective and preventive control activities.

10.3.4. Information and Communication

10.3.4.1. Information and communication are essential to realising all internal control activities. A precondition for reliable and relevant information is the prompt recording and proper classification of transactions and events. Pertinent information should be identified, captured and communicated in a form and timeframe that enables staff to carry out their internal control and other responsibilities (timely communication to the right people). Therefore, the internal control system as such and all transactions and significant events should be fully documented.

10.3.4.2. Information systems produce reports that contain operational, financial and non-financial and compliance-related information and that make it possible to run and control the operation. They deal not only with internally generated data, but also information about external events, activities and condition necessary to enable decision making and reporting.

10.3.4.3. Management's ability to make appropriate decision is affected by the quality of information which implies that the information should be appropriate, timely, current, accurate and accessible.

10.3.4.4. Effective communication should flow down, across, and up the organisation, throughout all components and entire structure. All personnel should receive a clear message from top management that control responsibilities should be taken seriously. They should understand their own role in the internal control system as well as how their individual activities relate to the work of others. There also needs to be effective communication with external parties.

10.3.5. Monitoring

Internal control system should be monitored to assess the quality of the system's performance over time. Monitoring is accomplished through routine activities, separate evaluation or a combination of both. Ongoing monitoring of internal control is built into the normal,

recurring operating activities of an entity. It includes regular management and supervisory activities, and other actions personnel take in performing their duties.

10.4. Separate Evaluation

The scope and frequency of separate evaluations will depend primarily on the assessment of risks and the effectiveness of ongoing monitoring procedures. Specific separate evaluations cover the evaluation of the effectiveness of the internal control system and ensure that internal control achieves the desired results based on predefined methods and procedures. Internal control deficiencies should be reported to the appropriate level of management. Monitoring should ensure that audit findings and recommendations are adequately and promptly resolved.

10.5. Internal Audit

Modern organizations view internal audit as an element of the overall infrastructure of Internal Control. Internal auditors review the organization's operations, report their findings and recommend improvements. By so doing, they help senior managers discharge their responsibilities more effectively. In most countries, internal audit has evolved into a distinct profession. As defined by the Institute of Internal Auditors (IIA), *"Internal auditing is an independent, objective, assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve effectiveness of risk management, control, and governance processes"*(1999)

10.6. Internal Audit Standards

The adoption of and adherence to internal audit professional standards, such as that issued by the IIA, can enhance the effectiveness of internal audit. The mandates of many modern internal audit organizations in fact require compliance with such standards. The new IIA standards (<http://www.theiia.org>) will be effective January 1, 2002 but earlier adoption is encouraged. While there is one set of *Attribute* and *Performance Standards*, there may be multiple sets of Implementation Standards: a set for each of the major types of internal audit activity.

10.6.1. Attribute Standards

- The internal audit activity should be independent, and internal auditors should be objective in performing their work.
- Engagements should be performed with proficiency and due professional care.
- The chief audit executive should develop and maintain a quality assurance and improvement program that covers all aspects of the internal audit activity and continuously monitors its effectiveness. The program should be designed to help the internal auditing activity add value and improve the organization's operations and to provide assurance that the internal audit activity is in conformity with the *Standards* and the *Code of Ethics*.

10.6.2. Performance Standards

- The chief audit executive should effectively manage the internal audit activity to ensure it adds value to the organization.

- The internal audit activity evaluates and contributes to the improvement of risk management, control and governance systems.
- Internal auditors should develop and record a plan for each engagement.
- Internal auditors should identify, analyze, evaluate, and record sufficient information to achieve the engagement's objectives.
- Internal auditors should communicate the engagement results promptly.
- The chief audit executive should establish and maintain a system to monitor the disposition of results communicated to management.

10.7. Scope and Effectiveness of the Internal Audit

10.7.1. Internal auditors were traditionally concerned with the reliability of accounting and management information systems; compliance with policies, laws, regulations, rules and procedures; and the safeguarding of organizational assets and resources. However, they now increasingly cover organizational performance, including the economy in using resources, efficiency of operations and effectiveness in achieving organizational objectives, with extended-scope audits such as 'value-for-money', 'operational', and 'management' audits. In other words, their work extends beyond the financial accountability area. In addition, the evolving practice of internal auditing in government is gradually adopting the best practices from the private sector:

- Becoming more customer orientated and being proactive to the needs of the organization and the manager
- More future orientated by focusing more on risk management
- Becoming involved early in the design, development and implementation stages of systems and programs and
- Improving the methodology through increased use of new techniques such as statistical sampling, customer surveys, computer assisted audit techniques

10.7.2. As government organizations continue to restructure by becoming less bureaucratic through delegation of authority and decentralization, internal auditors play a greater role in improving public accountability and efficiency of government operations. However, this depends to a large measure on how the government and managers support internal auditors, particularly in providing them with operational independence and adequate resources, and taking appropriate actions further to their reports.

CHAPTER 11

AUDIT OF FRAUD

11.1. Introduction

Examination of system for detection and prevention of fraud and corruption will be an integral part of all regularity audits and performance audits, when it forms one of the audit (sub) objectives. Office of the Comptroller and Auditor General of India issued a standing order on role of Audit in relation to cases of Fraud and Corruption in September 2006.

11.2. Fraud examination

Fraud examination is a part of the normal auditing procedures and includes:

- being alert for situations of control weaknesses and inadequacies in record keeping errors and unusual transactions or results which could be indicative of fraud/corruption, improper expenditure or lack of probity; and
- focusing audit strategy on areas and operations prone to fraud and corruption by developing effective high risk indicators for fraud..

11.3. Characteristics of fraud

11.3.1. Fraud should be distinguished from error. The distinguishing factor between fraud and error is whether the underlying action is intentional or unintentional for example, the following actions amount to error and not fraud :

- A mistake in gathering or processing data from which financial statements are prepared.
- An incorrect accounting estimate arising from oversight or misinterpretation of facts: and
- A mistake in the application of accounting principles relating to measurement, recognition, Classification, presentation or disclosure.

11.3.2. The meaning and nature of Fraud can be understood by referring to the following definitions.

- Fraud is an intentional act by one or more individuals among management, those charged with governance, employees or third parties involving the use of deception to obtain an unjust or illegal advantage.
- Fraud involves deliberate misrepresentation of facts and/or significant information to obtain under or illegal financial advantage.

11.3.3. Fraud involving one or more members of management or those charged with governance is referred to as “management fraud”. Fraud involving only employees of the entity is referred to as “employee fraud.” In either case, there may be collusion within the audited entity or with third parties outside the audited entity.

11.3.4. Fraud has legal (criminal) connotation. Auditors do not make legal determinations of whether fraud has actually occurred. They can report suspected or presumptive fraud.

11.3.5. Ample caution needs to be exercised before terming an act as “Fraud”. For an act to come within the ambit of fraud the following elements are required to be present.

- The act is intentional on the part of one or more individuals working in collusion with each other.
- The objective of the act is to obtain or give illegal advantage in violation of the laws, rules and guidelines existing on the subject:
- An act committed in good faith, which by subsequent turn of events, proves to be incorrect or based on wrong information is not fraud.
- The advantage or benefits to an individual or a group of individuals will have to be tangible and not notional or presumptive and
- Such act would cause loss to exchequer or be against public interest.

11.3.6. Fraud may involve:

- Manipulation, falsification or alteration of records or documents
- Misappropriation, misapplication of assets
- Suppression or omission of the effects of transactions from records or documents.
- Recording of transaction without substances and
- Misapplication of accounting policies.

11.4. Characteristics of corruption

11.4.1. Corruption is a complex issue. The following definitions indicate the nature of corruption.

- Corruption involves behavior on the part of officials in the public and private sectors, in which they improperly and unlawfully enrich themselves and/ or those close to them or induce others to do so by misusing the position in which they are placed.
- Corruption is the abuse of public power for personal gain or for the benefit of a group to which one owes allegiance.

11.4.2. An act of corruption would comprise of one or more of the following elements:

- There must be at least two parties. viz., the person who offers the reward or inducement and the party accepting it;
- There must be misuse of office or position of authority for private gain;
- There is either an offer and/or acceptance of inducements.
- An attempt to solicit an offer of inducement or reward as benefit for performance of an official act;
- Any act through which public or entity property is dishonestly misappropriated;
- There may be an attempt to camouflage; and
- Corruption involves breach of trust.

11.5. Respective Responsibilities of Management and Audit

11.5.1. Responsibilities of Management

11.5.1.1. It is the responsibility of those charged with governance of the entity to ensure oversight of management that the entity establishes and maintains internal control to provide reasonable assurance with regard to reliability of financial reporting effectiveness and efficiency of operations and compliance with applicable laws and regulations.

11.5.1.2. In relation to fraud, it is important to recognize that the responsibility for the prevention and detection of fraud and error rests primarily with the management of the audited entity through a system of internal control. The responsibility for adequate and timely disclosure of any cases of fraud and corruption rests with the management and the responsibility of ensuring reliability and results of operation must include concerns arising from risk of fraud and corruption. The management is expected to document the system established for prevention, detection, follow-up and reporting of fraud and corruption.

11.5.2. Responsibilities of Audit

11.5.2.1. Detection of fraud is not the primary objective of audit. Audit must, however evaluate and report on the adequacy and competence with which the management has discharged its responsibility in relation to prevention, detection, response and follow-up/remedial measures in relation to fraud and corruption. The auditor should make the management aware of the absence or lack of application of reliable and valid performance measures and indicators should increase the possibility of occurrence of fraud and corruption.

11.5.2.2. Audit should be alert to shortcomings in systems and controls that are likely to provide an environment conducive for fraud and corruption and should recommend to the management measures to improve the control environment and minimize the risk of fraud and corruption.

11.5.2.3. During audit of financial statements, two types of internal misstatements are relevant to the auditor. viz., misstatements resulting from fraudulent financial reporting and misstatements resulting from misappropriation of assets.

11.6. Professional skepticism

Professional skepticism is an attitude that includes a questioning mind and acritical assessment of audit evidence. Professional skepticism requires a questioning of whether the information and audit evidence obtained suggests the existence of fraud having a material effect on audit findings/ opinion.

11.7. Fraud awareness at the audit planning stage

11.7.1. The field officers should carry out an independent risk assessment and prioritize their audit planning accordingly. This should include consideration of any information received from the public or media on suspected cases of fraud and corruption. The audit plans should focus on high-risk areas.

11.7.2. some of the high risk area are contracts of service/ procurement, inventory and asset management, sanctions/ clearances, performance information, revenue receipts, csh management, general expenditure, grants, financial statements, operating information, computerized environment, privatization of public sector functions etc.,

Vigilance about fraud at audit execution stage

11.7.3. At the commencement of each audit. information about the fraud awareness and related environment should be collected from the audited entity management.

The information should include inter alia;

- Policy and system to prevent and detect fraud/corruption and reporting;
- System to establish accountability for fraud /corruption
- Fraud/ corruption indicators;

- Instances of fraud and corruption noticed since last audit
- Action taken on such cases including strengthening of internal control systems.
- Special areas prone to risk of fraud and corruption and
- Guidelines issued by management with regard to control of fraud and corruption.

11.7.4. During the course of audit, the audit personnel should be vigilant and seek explanations if it comes across possible fraud indicators.

11.8. Computer evidence

Since many records are produced by computers in the usual and ordinary course of work auditors should understand how to collect and handle those records as audit evidence. Collecting computer evidence requires careful planning and execution. Auditors should examine whether appropriate controls are in place in order to ensure the authenticity of computer evidence.

11.9. IT fraud

IT fraud could involve the manipulation of a computer data by whatever method in order to dishonestly obtain money, property or some other advantage of value or to cause loss.

The Auditor has to be particularly aware of the audit trail, of the checks and balances of IT systems, of the levels of control and needs to also have a fair idea of how processing controls can be circumvented by the preparator of fraud and how data can be accessed and manipulated. It is particularly important for the auditor of the IT system to access in his audit the level of scrutiny controls built in and if these are in tune with the sensitivity of data.

Audit evidencing in an IT environment is often more complex than traditional manual audit. In an IT environment, not only it is necessary to understand the techniques of assessing system and data soundness but also necessary to establish means of collecting evidence.

11.10. Types of Fraud and corruption in Contracts

The following types of fraud and corruption have been reported in contracting for goods and services:

- Bribery and kickbacks – Money or any other form of reward or favour is exchanged between a public functionary and a provider of goods and services in order to obtain some benefit e.g. acceptance of standard goods or obtaining unauthorized information.
- Changes in Original Contracts – Changes are made in the original contract requiring flow of additional funds from the government to the contractor, which may affect the basis on which the contract was awarded to the contractor in the first instance. This may also involve front-loading of contract in the hope of increasing the price of the original contract through change orders or subsequent modifications to the Contract.
- Duplicate Payments – The Contractor claims and receives payment for the same service or work done or goods supplied under the same or different contracts.
- Collusive or Cartel Bidding – Contractors form cartels to fix artificially high prices for goods and services supplied by them.
- Conflict of Interest – Contracts are awarded on the basis of vested interests of the decision makers.

- Defective Pricing – The Contractor submits inflated invoices.
- False Invoices – The Contractor submits invoices for goods that have not been delivered or do not properly represent the quantity or quality of goods and services supplied or work done as per contracted specifications.
- False representations – The Contractor falsifies the goods specifications or his ability to provide certain services.
- Splitting of Purchases – The purchases of goods and services are split either to avoid open competition or having to seek the approval of higher authority.
- Phantom Contractor- Purchase are made from a fake supplier or contractor.
- Pilferage of Public Assets - Public funds are used to acquire goods for personal use or public assets pilfered by officials.
- Tailored specifications – Specifications and time limits are manipulated to favor a certain contractor or supplier.

11.11. Warning signs of Possible Fraud and Corruption in Contracts

Procurement and contracting of goods and services present different opportunities for fraud and corruption at different stages of the procurement and contracting processes. The auditor would be well advised to look out for warning signs corresponding to each stage. These warning signs indicate the increased risk factor in contracts and serve as red flags for the auditor.

- Requirements defining stage
- Inadequate needs analysis
- Inadequate information about potential suppliers
- Inadequate review of existing and required inventory
- Unduly short supply period
- Needs analysis is product oriented rather than needs oriented
- Someone other than the user defines the user requirements
- Unwarranted involvement of senior officials
- Bidding and selection stage
- The specifications are not clearly defined
- A very limited number of offers is received
- Documentation indicates unusual involvement of an official
- Suspicion about conflict of interest
- Evidence of early receipt of information by some contractors
- Request for proposal is not properly advertised
- Unusual handling of the bidding process
- Evaluation criteria is not consistent for different offerers

- Exceptions to the tender deadlines
- Changes in the bids made after their formal receipt
- Lowest responsive bidder is not selected
- Contractor submits unrealistic bid indicating collusion or bid rotation
- Unusual withdrawal of bids
- Re-bid results identical to original bids
- Successful contractors use competitors as sub-contractors
- Justification for single source procurement is inadequate
- Contract performance and evaluation stage
- Changes in a contract result in the large increase in the cost of goods and services
- Changes made without adequate explanations
- Unwarranted contract extension
- Complaints about the quality of goods and services received
- Inadequate inspections and quality assurance of goods and services received
- Evidence of over charging and duplicate billings
- Dubious invoices
- Insufficient pre-audit of contractor payments
- Contracts repeatedly awarded to one contractor
- Unduly high labor payments

11.12. Audit Evidence

In searching for the evidence of fraud and corruption the auditor must:

- Always search for the strongest possible evidence;
- Investigate without delay, as evidence can be destroyed, lost or forgotten;
- Not ignore small clues or leads;
- Look for facts that confirms or refute suspicions;
- Concentrate on the weakest point in the fraud and corruption.
- Identify and summarize the evidence indicating that fraud and corruption may have been committed;
- Identify the possible scenario of fraud and/or corruption;
- Summarize and explain the accounting and control systems involved, the paper trail involved in the transaction, and the deviations from the systems;
- Explain patterns used in covering up the fraud and corruption;
- Identify the possible extent of the fraud and corruption; and
- Consider the possibility of collusion.

11.13. Sources of Evidence

- Documents from the auditee: During the course of examination of books of accounts, auditors investigate various documents that serve as evidence for the audit. These documents may be originals or photocopies depending upon their importance.
- Report of Internal Auditor: The internal auditor may have identified instances of deviation from normal procedure.
- Interviews: Auditors can obtain important information from various government employees. Since they may have noticed internal control failure made by managers and fraudulent activities perpetrated by other employees, interviews may be useful in detecting material misstatements caused by fraud and corruption.
- Inspection/Observation: Auditors can notice possibility of fraud and corruption through the examination of inspection/observation/physical verification reports (e.g. forged documents, inventory not in existence or inferior quality). Where any auditor relies on physical observation for an audit conclusion this would need to be supported with properly documented evidence.
- Questionnaires: Auditors may gather important and helpful information by using questionnaires.
- Confirmation with other related parties: Auditors sometimes obtain information directly from other related parties (e.g. bank balance confirmation from the bank. Debtor's balance confirmation from individual debtors etc). If the figures provided by these agencies do not tally with the books of account, they should check in detail to find out the reason for discrepancy.
- Results of Analytical Review: Auditors analyze both financial and non-financial information, which can indicate abnormal trends. In that case, auditors need to concentrate on particular areas.
- Expert Opinion: Auditors may seek expert opinion about a suspicious case. The expert's opinion becomes evidence if auditors can rely on that opinion in assessing fraud and corruption.

11.14. Reporting

11.14.1. Reports of individual cases of suspected/ presumptive fraud corruption should be addressed confidentially in the first instance to the controlling authority concerned with the approval of Group Officers. Copies may simultaneously be sent confidentially to higher authority in cases that are regarded to be so grave or serious.

11.14.2. In addition to reporting to the management of the audited entity, material/significant cases of fraud and corruption may be reported through separate confidential letters to the specified investigating agency like Central Bureau of Investigation(CBI) Central Vigilance Commission(CVC) in case of Union Government with the approval of PDCA.

11.15. Follow-up

Cases relating to suspected/presumptive fraud and corruption should be highlighted in the Inspection Reports, Audit Notes, etc. and also in the Audit Reports. All such cases should be printed in bold type.

11.16. Reporting to investigating agencies

11.16.1. PDCA should carry out a quarterly review of the audit findings contained in the inspection reports, audit notes etc relating to different wings of their offices and bring specific material/ significant cases of suspected fraud or corruption.

11.16.2. While forwarding the Bond Copy of the Audit Reports to Headquarters, PDCA should highlight in the forwarding letter the number of cases of suspected fraud and corruption together with the money value of the concerned paras included in the bond copy. All such cases should be taken up immediately after approval of the bond copy with the appropriate vigilance or investigative authorities by PDCA even if these cases were reported to them earlier. Such cases should be forwarded to the vigilance or investigative authorities such as the Central Bureau of Investigation Central and State Vigilance Commissions, Loka yukta, etc through confidential letters drawing reference to earlier correspondence, if any, with additional information that these cases have been included in the CAG's Audit Report to Parliament/ State Legislature.

11.16.3. While forwarding such cases, PDCA should also send a brief write-up of such cases with details of the names of individuals firms address etc and any other necessary information available in field offices which are not mentioned in the Audit Report as per our reporting policy. It should be clearly stated in the communication that in view of the intent of Audit to bring the matter to the notice of Parliament/Legislature, strict confidentiality should be maintained about the matter to avoid any likely breach of privilege of Parliament/ Legislature.

CHAPTER 12

MISCELLANEOUS

12.1. Audit of Public Private Partnership Projects

The concept of Public Private Partnership (PPP) Projects is relatively new and are executed and operated within a framework of a complex arrangement of risk sharing amongst stakeholders. Considering the continuing innovation in the development of appropriate business models for PPPs in various socio-economic sectors and the need to develop in each field audit office a broad awareness on the subject amongst officers and staff, the CAG's Office has issued Public Private Partnership (PPP) in Infrastructure Projects - Public Auditing Guidelines, 2009. These are to be adapted to the audit of joint ventures set up by DPSUs.

12.2. Direct access to private sector records for audit by the CAG

The duties and powers of the CAG to directly access and audit the records of the private sector had been under discussion for some time. The issue was examined by the Hon'ble Delhi High Court and the Supreme Court of India in the case of access of records of private telecom companies by the CAG. They recognized that the records of private players entrusted with the responsibility of delivering public goods and services by utilising the state owned resources should be accessible to the CAG for audit. The CAG's Office has issued a Guidance Note highlighting the important arguments accepted and the rationale behind the judgements that have wider implications for audit by the CAG of private sector organizations.

12.3. Role of CAG in the changing environment

In essence, the judgments have emphasized that the duties and powers of the CAG, being part of the basic structure of the Constitution, are to be interpreted and carried out to meet the changing needs and requirements of accountability. In the current scenario, the purpose of audit by CAG of records of private sector organizations has been stated in the Guidance Note as under:

- Providing an independent assurance that the terms and conditions of the agreements have been complied with in letter and spirit;
- Assisting in protecting the legitimate interest of public at large;
- Ensuring parliamentary oversight.

It holds that an independent assurance by the CAG, as an external auditor, to the Government is necessary and different from the roles of the executive, the statutory auditor and the regulator; as the audit of such private sector records is to safeguard the interests of the State or its agencies or instrumentalities, it is the constitutional mandate of the CAG; therefore, there may be no requirement of specific entrustment of such audits.

12.4. Procedure for accessing/auditing private sector records

12.4.1. Identification of agreements involving private sector participation

This office has to prepare a master database of all agreements entered into by the DPSUs with private sector by considering the presence of one or more of the under-mentioned parameters:

- For delivery of public goods and services
- Dealing with transfer of natural resources (like land, water, spectrum and genetic resources) or public properties to private sector, if such transfer affects public interest
- Nexus with Consolidated Fund of India or State
- Having an impact on public interest.

12.4.2. Determination of need to access private sector records

Where this office has determined in any particular case that direct access to private sector records is required, proposals seeking approval for such direct access need to be prepared and forwarded to controlling DAI/ADAI giving justification/necessity and the list of records to be accessed. The following aspects are to be kept in view while seeking such approval:

- The contract may provide for specific agreement clauses requiring private sector organisations to provide access to information/records to public sector partners or any other public authority;
- In most of the cases, it may be possible to get the required information through the public sector audited entity entering into agreement with the private sector entity in question; the public sector entity should be the first port of call;
- In certain cases, it would not be possible to provide assurance that the terms and conditions of the agreement are being complied with, unless the underlying records that are in the exclusive custody of the private sector organisation are examined;
- In all cases, the materiality and the risk perception need to be given due consideration.

12.4.3. Scope of examination of private sector records

The scope and the extent of examination of private sector records needs to be clearly understood with reference to the applicable section of the CAG's (DPC) Act. The following factors need to be considered while deciding the scope of the audit of such records:

- The access to private sector records should be limited to compliance audit to ensure that the terms and conditions of the agreement in question have been complied with; a financial audit or the performance audit of the private sector organisation is not to be undertaken;
- In case of performance audit of public sector audited entities, there may be a need to access the records of private sector partners. Even in such cases, the audit of private sector records would be restricted to checking of compliance with the terms and conditions of the agreement;
- Only those underlying records are to be examined which are essential to provide assurance for the above; request for access to be restricted to such documents only;
- The scope should clearly indicate the time/ period to be covered and the records to be accessed; audit should not be open ended.

12.4.4. Mode of interaction with private sector

The following communication protocol should be followed while auditing records of private sector organisations:

- Private sector should be approached, initially through administrative department/public sector audited entity; scope and methodology of audit should be explained upfront to the private sector entity, clarifying doubts, if any;
- Liaison officers from administrative department/public sector entity, private partner and the Main Office should be appointed for effective coordination; a regular communication channel would help in audit management;
- Concerned administrative department/public sector entity should be kept informed of all important developments during the course of the audit;
- All possible constraints in conduct of the audit should be identified and mitigating strategies planned.

12.4.5. Composition of audit parties and capacity building

The following aspects are to be kept in view while selecting audit parties for such audits:

- The audit teams deputed should possess necessary professional competence to conduct such audits as a group. This would include knowledge of the domain of the audited entity, sound knowledge of auditing techniques as well as analytical, writing and communication skills. The considerations for selection of a particular team should be placed on record.
- This office should evaluate whether and in what areas external expertise is required and makes the necessary arrangements to complement the knowledge of the audit teams. The general guidelines approved by the CAG's Office for procurement of services of external experts are to be adhered to for their selection.
- Effective supervision of the implementation of such audits should be ensured to perform audit as planned. The audit teams should be guided by the group officers concerned on a regular basis.
- Emphasis should be laid on specific capacity development and training needs should be properly addressed.



Principal Director of Commercial Audit

Annexure I

Profile of Defence PSUs

1. Hindustan Aeronautics Limited

Hindustan Aeronautics Limited (HAL) was incorporated in October 1964 under the administrative control of the Ministry of Defence (Department of Defence Production). The Company was conferred 'Navratna' status by the Government of India in 2007. The Company has five business groups/complexes viz. Bengaluru complex, MiG complex, Accessories complex, Helicopter complex and Design complex. The Company is engaged in the manufacturing of Su-30 MKI aircraft, Hawk aircraft, Dornier aircraft, advanced light helicopter, Cheetal helicopter, and light combat aircraft – Tejas along with related engines and accessories. The Company also provides repair and overhaul services for various aircrafts and helicopters.

HAL has a comprehensive design and development set-up and is engaged in the development of intermediate Jet trainer aircraft, fifth generation fighter aircraft, multi role transport aircraft, light combat helicopter and light utility helicopter, etc. The Company was listed on 28 March 2018.

The Company has formed 14 joint ventures with private companies/ vendors in the areas of software development, product support, design of avionics etc. with a total investment of ₹97.15 crore. It also has two subsidiaries with a total investment of ₹8.54 crore.

Authorised capital of HAL, as of 31 March 2021, was ₹600.00 crore. The paid-up equity was ₹334.39 crore, of which, ₹251.29 crore (75.15 *per cent*) was held by the Government of India and ₹48.38 crore (14.47 *per cent*) was held by Life Insurance Corporation of India (LIC).

The Company's total revenue during the year 2020-21 was ₹23113.25 crore and it had earned a profit of ₹3232.96 crore.

Naini Aerospace Limited (Subsidiary of HAL)

Naini Aerospace Limited was incorporated as a fully owned subsidiary of HAL on 29 December 2016 having its registered office in Bengaluru. The Company was incorporated with an authorized capital of ₹50 crore and paid up capital of ₹50 crore. In accordance with the decision of the Union Cabinet, Naini Aerospace Limited took over the Naini unit of Hindustan Cables Limited (HCL) on 01 February 2017 to start the business operation in the aerospace and aviation sector. The Company proposed to undertake fabrication of looms for helicopters and aircraft at Naini, Prayagraj and provide support to the second production line of ALH being set up at Transport Aircraft Division (TAD) Kanpur. The initial operations of looms for ALH and LCA have started from 10 July 2017. The Company earned an income of ₹5.40 crore and accounted a loss of ₹11.04 crore for the period ending 31 March 2021.

Indo Russian Helicopters Limited (Subsidiary of HAL)

Indo Russian Helicopters Limited (IRHL), a subsidiary of HAL, was set up to produce 200 Kamov 226T helicopters in India based on the inter-governmental agreement concluded between the Government of India and the Government of the Russian Federation on 24 December 2015. IRHL was incorporated as a subsidiary company of HAL on 02 May 2017 with a shareholding of 50.5 *per cent* by HAL and 49.5 *per cent* by the Russian Helicopters and Rosoborenexports. HAL had contributed ₹5.05 crore towards the total equity share capital of ₹10 crore. The subsidiary would also organize maintenance and operative repairs of the helicopters.

The Company earned an income of ₹0.53 crore and accounted a loss of ₹0.80 crore for the period ending March 2021.

2. Bharat Electronics Limited

Bharat Electronics Limited, Bangalore was incorporated in April 1954 as a fully owned Government of India Undertaking under the Ministry of Defence with the objective of designing, developing, manufacturing and supplying electronic equipment such as radars, communication equipment, naval systems, broadcasting equipment, telecommunication equipment, components etc., required by defence and civil customers. Government of India has conferred “*Navratna*” status to BEL on 22-06-2007. The Company has, at present, nine production units situated at Bangalore, Chennai, Hyderabad, Machilipatnam, Pune, Navi Mumbai, Ghaziabad, Kotdwara and Panchkula. The Company has one Joint Venture Company (JVC) viz. GE-BE Private Limited and two subsidiary companies viz. BEL Optronics Limited and BEL-Thales Systems Limited.

Authorised capital of the Company, as on 31 March 2021, was ₹250.00 crore. The paid-up equity was ₹243.66 crore of which ₹124.60 crore (51.14 *per cent*) was held by the Government of India. The Company’s total revenue during the year 2020-21 was ₹14189.93 crore and it earned a profit of ₹2045.62 crore.

BEL Optronics Limited (Subsidiary of BEL)

BEL Optronics Limited (BELOP), Pune is a fully held subsidiary of Bharat Electronics Limited (BEL), Bangalore. The Company was established for conducting research, development and manufacture of Image Intensifier Tubes for use in military, security and commercial systems.

Authorized capital of the Company, as on 31 March 2021, was ₹100.00 crore and the paid-up capital was ₹84.51 crore fully held by Bharat Electronics Limited. The Company’s total revenue during the year 2020-21 was ₹59.53 crore and it had earned a profit of ₹4.90 crore.

BEL Thales Systems Limited (Subsidiary of BEL)

BEL Thales Systems (BTSL) was incorporated in India on 28 August 2014 as a Limited company under the Companies Act 2013. The company is a subsidiary of BEL. The Company obtained approval from Ministry of Company Affairs for commencement of its

business on 21 November 2014. The primary focus of the company is to Design, Develop, Supply and Support of Defence and civilian Radars.

Authorized capital of the Company, as on 31 March 2021, was ₹80.00 crore with the paid-up capital being ₹57.62 crore, of which ₹42.64 crore (74 *per cent*) was held by BEL. The Company started commercial operations in 2016-17 and the Company's total revenue during the year 2020-21 was ₹38.72 crore and it had earned a profit of ₹3.15 crore.

Defence Innovation Organisation

Defence Innovation Organisation (DIO) is an initiative by the Ministry of Defence, aimed at creation of an ecosystem to foster innovation and technology development in Defence by engaging R&D institutes, Academia, industries including MSMES, start-ups and individual innovators.

DIO was incorporated on 10th April 2017 as a 'Not for Profit' Company as per the provisions of Section-8 of the Indian Companies Act 2013 with an authorised share capital of ₹1 crore as on 31 March 2021 and the paid up capital was ₹1 lakh (BEL: 50 *per cent*; HAL: 50 *per cent*). The Company has been formed with an objective of funding innovation in defence sector. BEL paid a grant of ₹5 crore on 11 October 2018 to DIO. The Company's total revenue during the year 2018-19 was ₹ 1.08 crore.

3. BEML Limited

Bharat Earth Movers Limited was incorporated (May 1964) as a public sector undertaking for manufacture of rail coaches, mining equipment and spare parts and was later renamed (2006) as BEML Limited. The Company has been conferred with 'Mini Ratna' Category-1 status since August 2006.

The Company has one subsidiary *viz.* Vignyan Industries Limited and two joint ventures *viz.* M/s. BEML Midwest Limited and MAMC⁴ Industries Limited.

The Company has nine manufacturing units located at Bengaluru, Kolar Gold Fields (KGF), Mysuru and Palakkad. The Company manufactures variants of Tatra vehicles for all terrain operations and supplies Engineering Mine Ploughs, Tank Transportation Trailers, Weapon Loading Equipment, Armored Recovery Vehicles, Minrail Coaches and Wagons apart from Aircraft Weapon Loading Trolley and Aircraft Towing Tractors.

Further, the Company offers a comprehensive and diverse range of mining machinery for both opencast and underground mines and it supplies equipment to Indian Railways. The Company has forayed into high-tech metro trains deployed for intra-city commuting. The Company launched its aerospace vertical during the year 2007 to exploit the potential of the engineering services in the aerospace domain for which an aerospace manufacturing facility was established in Mysore Complex of the Company.

⁴ JV partner is Mining and Allied Machinery Corporation Limited (MAMC)

Authorised capital of the Company, as on 31 March 2021, was ₹100.00 crore . The paid-up capital was ₹41.64 crore, of which ₹22.50 crore (54.03 *per cent*) was held by the Government of India. The Company's total revenue during the year 2020-21 was ₹3617.37 crore and it earned a profit of ₹74.80 crore.

Vignyan Industries Limited (Subsidiary of BEML)

Vignyan Industries Limited at Tarikere, Chikmagalur district, was taken over by BEML Limited in 1984 and is functioning as a subsidiary Company. VIL is a Steel Casting Foundry supplying quality steel and alloy castings to various manufacturing units of BEML Limited.

Authorised capital of the Company, as on 31 March 2021, was ₹3.8 crore. The paid-up capital was ₹2.79 crore, out of which ₹2.69 crore (96.56 *per cent*) was held by BEML Limited. The Company's total revenue during the year 2020-21 was ₹ 1.44 crore and it incurred a loss of ₹ 6.12 crore.

BEML Land Assets Limited (Subsidiary of BEML)

BEML Land Assets Limited (BLAL) is an unlisted public company which was incorporated on 15 July 2021. As on 31 March 2021, 100% of the shareholding is held by BEML. Board of Directors of BEML in their meeting held on 23 July 2021 approved a scheme of Arrangement between BEML and BLAL for demerger of Identified Surplus/ Non core Assets from BEML and its vesting in BLAL.

The Company prepared its financial statements for the first time for the year 2021-22 and to the end of March 2022, its authorized share capital is ₹ 1,000,000 and its paid up capital is ₹100,000.

4. Bharat Dynamics Limited

Bharat Dynamics Limited (BDL), established in July, 1970 is the prime agency for manufacture of Missiles in the country and is under the administrative control of Ministry of Defence. The Company has its Registered Office at Kanchanbagh, Hyderabad and manufacturing units at Kanchanbagh, Bhanur (Medak District) and Vishakapatnam.

The Company manufactures anti-tank guided missiles (Milan 2T, Konkur, Invar (3UBK 20)), Akash Missiles, Advanced Lightweight Torpedoes, Torpedo Counter Measure Systems, Counter Measure Dispensing Systems, and Infra-Red Interference Indicators.

Authorised capital of the Company, as on 31 March 2021, was ₹200.00 crore . The paid-up capital of the Company was ₹183.28 crore of which ₹137.33 crore (74.93 *per cent*) was held by the Government of India, ₹18.74 crore (10.23 *per cent*) was held by LIC, ₹10.92 crore (5.96 *per cent*) was held by HDFC Trustee Company Limited . The Company's total revenue during the year 2020-21 was ₹2008.37 crore and it earned a profit of ₹257.77 crore.

5. Mishra Dhatu Nigam Limited

Mishra Dhatu Nigam Limited (MIDHANI), established in November 1973, was set up to fulfill the need for Self-reliance in hi-tech special metals and alloys which had become

essential for meaningful growth of Space, Atomic Energy, Aeronautical, Steel and Hydro-electric power & Defence sectors.

Company has a Registered Office and Manufacturing Unit at Kanchanbagh, Hyderabad, a Regional Office at New Delhi and two Commercial Offices at Kolkata and Chennai.

Company has modern metallurgical facilities and high degree of technical competence in manufacturing a wide range of Super-alloys, Titanium, Special Purpose Steels and other special metals and alloys meeting stringent international standards for application in Aerospace, Defence, Atomic Energy, Power Generation, Chemical and other hi-tech industries.

Authorised capital of the Company was ₹ 200.00 crore as at 31 March 2021. The paid up capital was ₹ 187.34 crore, out of which, 74% was held by the Government of India and 8% by HDFC Trustee Company. The Company's total revenue during the year 2020-21 was ₹ 833.06 crore and it earned a profit of ₹166.29 crore.

Utkarsha Aluminium Dhatu Nigam Limited (A Joint Venture of NALCO & MIDHANI)

Utkarsha Aluminium Dhatu Nigam Limited was incorporated on 21st August 2019 as a joint venture between MIDHANI and NALCO with an authorized capital of ₹ 300 crore and paid-up capital of ₹ 40 crore (₹ 20 crore each from MIDHANI and NALCO) to manufacture, market, sell, import, export of all high end aluminum alloy products to fulfill the requirements of critical, strategic sectors viz., defence, space, atomic energy, aerospace, aviation, transport and other domestic and overseas customers.

6. Mazagon Dock Shipbuilders Limited, Mumbai

Mazagon Dock Shipbuilders Limited (MDL) (formerly known as Mazagon Dock Limited) established in 1934, is Country's one of the leading shipyard constructing warships as well as offshore platforms and functioning under the administrative control of Ministry of Defence, Govt. of India.

Main activities of the Company are ship building, ship repairs and fabrication of offshore structures with facilities situated at Mumbai and Nhava. Company is capable of building warships, submarines, merchant ships up to 30,000 DWT and fabrication of well head platforms, process and production platforms and jack up rigs. The company has successfully completed modernisation project named as "Mazdock Modernisation Project" (MMP) which was undertaken to upgrade the infrastructure and technology involving construction of an additional Wet Basin, creation of a Modular Workshop, Cradle Assembly Shop, erection of a 300-ton Goliath crane and Store building and ancillary structures. The expenditure towards these facilities was partially funded by Ministry of Defence.

Company has its Corporate Office at Mazagon in Mumbai, Regional office at New Delhi and two offshore offices at Russia & France.

Authorised capital of the Company, as on 31 March 2021, was ₹323.72 crore and paid up capital was ₹201.69 crore which was fully held by the Government of India. The Company's

total revenue during the year 2020-21 was ₹4648.02 crore and it earned a profit of ₹479.57 crore.

The Company had signed Memorandum of Understanding (MoU) with Ministry of Defence, Government of India MoD for the financial year 2020-21. The Company expects “Very Good” rating for its performance during the year 2020-21. At present, MDL is handling two Shipbuilding projects for Indian Navy, comprising of four ships of P15B & four ships of P17A each. Besides, MDL is also handling construction of six Scorpene class Submarines for the Indian Navy, out of which three Submarines have already been delivered.

7. Hindustan Shipyard Limited, Visakhapatnam

Hindustan Shipyard Limited (HSL), established in January 1951, is engaged in ship building and ship repairing activities. The administrative control of the Company, which was earlier under the Ministry of Shipping was transferred to Ministry of Defence during February 2010. The Company has its Registered Office and manufacturing unit at Gandhigram, Visakhapatnam.

Authorised capital of the Company, as on 31 March 2021 was ₹ 304.00 crore and paid up capital was ₹ 301.99 crore which was fully held by the Government of India. The Company’s total revenue during the year 2020-21 was ₹ 403.32 crore and it recorded a loss of ₹ 14 crore.

The Performance of the company for the year 2019-20 based on the self-appraisal is “Good” in terms of the MoU signed with the Ministry of Defence.

The first phase of the modernisation i.e. the Refurbishment and replacement of Machineries and Infrastructure (RRMI) is presently under progress with financial support from Govt. of India. Till 31 Mar 2020, orders worth ₹ 207.98 Cr have been placed. Out of which work for ₹ 180.77 Cr has been completed. The Major works during the year included refurbishment of 132 KV Station, installation of Data center, Establishment of E-learning Center, Renovation of Engineering & Ship Repair Complex etc.

8. Goa Shipyard Limited

Goa Shipyard Limited (GSL) established in 1957, is a leading ISO 9001-2008 certified shipyard on the West Coast of India, functioning under the administrative control of Ministry of Defence, Govt. of India. The Company has its Registered Office at Vasco da Gama, Goa. The Company generates revenue from ship construction / repairs, rendering general engineering services and supply of spares.

Authorised capital of the Company as on 31 March 2021 was ₹ 60.00 crore and paid up capital was ₹ 58.20 crore of which 51.09 *per cent* held by the Government of India and 47.21 *per cent* held by Mazagon Dock Shipbuilders Limited. The Company’s total revenue during the year 2020-21 was ₹ 978.76 crore and it earned a profit of ₹127.91 crore.

The performance of the Company for FY 2019-20 vis-à-vis MoU targets is under evaluation by Department of Public Enterprises and rating is awaited. The Company expects “excellent” rating for its performance during the year 2019-20 and “Very Good” for the year 2020-21. As

on 31 March 2021, order book position of the company stood at ₹ 14120 crore, which majorly consists of two OPVs for the Indian Coast Guard, two PCVs and two frigates of the P1135.6 series for the Indian Navy.

9. Garden Reach Shipbuilders and Engineers Limited, Kolkata

The Company, established in 1884, was initially named Garden Reach Works in 1916 and after taken over by Government of India in April 1960 and having diversified into engineering products, the name was changed to Garden Reach Shipbuilders and Engineers Limited on 01 January 1977. Company is engaged in shipbuilding, ship repairs, Engine assembling and testing and engineering products. Company has eight manufacturing units, seven units in and around Kolkata, West Bengal and one unit in Ranchi, Jharkhand.

Authorised capital of the Company as on 31 March 2021 was ₹125.00 crore and paid up capital was ₹ 114.55 crore, of which, ₹ 85.34 crore (74.50 *per cent*) was held by the Government of India and ₹ 9.73 crore (8.49 *per cent*) was held by HDFC Trustee Company Limited, ₹ 5.86 crore (5.12 *per cent*) was held by Nippon Life India Trustee Limited and the balance was held by others. The Company's total revenue during the year 2020-21 was ₹1328.43 crore and it had earned a profit of ₹ 153.47 crore.

The Company has been signing a Memorandum of Understanding (MoU) every year with the Government of India, Ministry of Defence. Performance of the Company is expected to be rated as "Very Good" as per MoU 2019-20 Evaluation. Further, on the basis of actual achievements vis-à-vis parameters laid down in the MoU signed with the Government of India for the year 2020-21, Company is expected to be rated "Excellent" for its performance during 2020-21.

As on 31 Mar 2021, the Company has an Order Book of ₹ 25,707 crore which comprises of ₹ 25,450 crore for Shipbuilding division and ₹ 252 crore for Engineering and Engine division.

Annexure II
List of Units of Defence PSUs

Sl. No.	Unit Name	Apex/ Audit Unit
	Bharat Electronics Limited	
1	BEL Corporate Office	Apex/ Audit Unit
2	Naval systems II	Audit Unit
3	Military Radar SBU	Audit Unit
4	Naval systems I	Audit Unit
5	Military Communications	Audit Unit
6	Export Manufacturing	Audit Unit
7	T&BS	Audit Unit
8	Missile Systems	Audit Unit
9	EW & A	Audit Unit
10	HLS	Audit Unit
11	Components SBU	Audit Unit
12	Central Services	Audit Unit
13	ADSN	Audit Unit
14	PDIC	Audit Unit
15	Radar & Antenna	Audit Unit
16	NCS	Audit Unit
17	DCCS	Audit Unit
18	SCCS	Audit Unit
19	Central Services	Audit Unit
20	Machilipatnam	Audit Unit
21	Hyderabad	Audit Unit
22	Chennai	Audit Unit
23	Kotwdara	Audit Unit
24	Panchkula	Audit Unit
25	Pune	Audit Unit
26	Navi Mumbai	Audit Unit
27	RO Delhi	Audit Unit
28	CRL, Ghaziabad	Audit Unit
29	BEL OP	Apex/ Audit Unit
30	BEL Thales	Apex/ Audit Unit
	BEML Limited	
31	BEML Corporate Office	Apex/ Audit Unit
32	Bangalore Complex	Audit Unit
33	Earth Movers Division	Audit Unit
34	Marketing Hqrs.	Audit Unit
35	Mysore Complex	Audit Unit
36	H&P DIVN	Audit Unit
37	Palakkad	Audit Unit

35	Mysore Complex	Audit Unit
36	H&P DIVN	Audit Unit
37	Palakkad	Audit Unit
38	RO-Bengaluru	Audit Unit
39	RO-Bilaspur	Audit Unit
40	RO-Dhanbad	Audit Unit
41	RO-Hyderabad	Audit Unit
42	RO-Kolkata	Audit Unit
43	RO-Mumbai	Audit Unit
44	RO-Nagpur	Audit Unit
45	RO-New Delhi	Audit Unit
46	RO-Neyveli	Audit Unit
47	RO-Ranchi	Audit Unit
48	RO-Sambalpur	Audit Unit
49	RO-Singrauli	Audit Unit
50	RO Chennai	Audit Unit
51	VIL	Apex/ Audit Unit
52	Bharat Dynamics Limited	Apex/ Audit Unit
53	Mishra Dhatu Nigam Limited	Apex/ Audit Unit
54	Utkarsha Aluminium Dhatu Nigam Limited	Apex/ Audit Unit
55	DIO	Apex/ Audit Unit
56	BEML Land Assets Limited	Apex/ Audit Unit
	Hindustan Aeronautics Limited	
57	HAL Corporate office incl DDO office	Apex/ Audit Unit
58	Aircraftb incl MDBC's (CEO,BC) office	Audit Unit
59	ASC	Audit Unit
60	LCA	Audit Unit
61	IJT LSP	Audit Unit
62	Engines	Audit Unit
63	IMGT	Audit Unit
64	Overhaul	Audit Unit
65	F&F incl F&F Central lab	Audit Unit
66	Aerospace	Audit Unit
67	FMD	Audit Unit
68	Helicopter	Audit Unit
69	MRO	Audit Unit
70	Barrackpore	Audit Unit
71	CMD	Audit Unit
72	ARDC incl. DDO	Audit Unit
73	RWRDC	Audit Unit

74	ETBRDC (AERDC)	Audit Unit
75	MCSRDC	Audit Unit
76	HMA	Audit Unit
77	Aircraft, Nasik	Audit Unit
78	AURDC MDM OfficeNashik	Audit Unit
79	Koraput incl. R&D	Audit Unit
80	Avionics Dn incl. SLRDC HYD	Audit Unit
81	Lucknow Dn incl.R&DC& ASERDC & MDA Office	Audit Unit
82	Korwa Dn incl. ASERDC	Audit Unit
83	Kanpur Dn incl. TARDC	Audit Unit
84	MDA Office	Audit Unit
85	MDM	Audit Unit
86	DDO	Audit Unit
87	MDBC	Audit Unit
88	IRHL	Apex/ Audit Unit
89	Naini Aerospace	Apex/ Audit Unit
90	Mazagon Dock Limited	Apex/ Audit Unit
91	Goa Shipyard Limited	Apex/ Audit Unit
92	Hindustan Shipyard Limited	Apex/ Audit Unit
93	Garden Reach Shipbuilding and Engineers Limited	Apex/ Audit Unit

APPENDIX -IX

[Refer to para 87]

**COMMON IRREGULARITIES /LAPSES OBSERVED IN
STORES/PURCHASE CONTRACTS AND GUIDELINES FOR
IMPROVEMENT IN THE PROCUREMENT SYSTEM**

Purchase Manual

The cardinal principle of any public buying is to procure the materials /services of the 'specified' quality, at the most competitive prices and, in a fair, just and transparent manner. To achieve this end, it is essential to have uniform and well documented policy guidelines in the organization so that this vital activity is executed in a well-coordinated manner with least time and cost overruns. In some of the organizations, the purchase manual is either not at all there or has not been updated for years together. Thus the system of procurement is quite adhoc and arbitrary.

- A codified purchase manual containing the detailed purchase procedures, guidelines and also proper delegation of powers, wherever required needs to be made by all the organizations so that there is systematic and uniform approach in the decision-making. Such an integrated approach is likely to put a cap on the corruption and would also ensure smoother and faster decision-making.

Filing System

The filing system adopted in most of the organizations is not satisfactory. Even the files are not being paginated. The part files are opened as and when new action is initiated and these part files are not merged with the main file, which inter-alia results in break in continuity and arbitrariness in decision making. The decisions / deliberations of the individuals or the Tender Committees are not properly documented or recorded which dilutes the accountability of the officers and may result in the 'interested' officers going scot free, even if serious lapses are established against them.

- The procurement files are very important and sensitive documents and thus there is a need to have a single file system with proper page numbering. In case of urgency, if opening of the part files is unavoidable, the same should thereafter be merged with the main file. The decisions and deliberations of the individuals or the Tender Committees also need to be properly recorded and well documented.

Provisioning

It has been noticed that in certain cases excessive, fraudulent and infructuous purchases were made without taking into consideration the important aspects like available stocks, outstanding dues / supplies, past consumption pattern and average life of the equipments / items etc. These excessive /infructuous purchases were at times made in collusion with the firms. This resulted in not only the material lying unutilized for years together with no residual life but also a lot of extra expenditure was incurred on the inventory carrying cost. One of the organizations took double procurement action for purchase of tyres against the same liability. Even the factors like shelf life of 5 years and the past consumption pattern were ignored while placing

the orders. As no action was taken to dispose off the surplus tyres, the department is incurring inventory carrying cost of about 20-25% per year for the last 10 years and the salvage value of the quantity held in stocks is likely to be 'Nil' due to expiry of the shelf life. In few cases, it was noticed that though the demand for the stores was simultaneously received from different wings / field units but, they were not clubbed together and were rather processed individually against the established principle of bulk buying.

- The provisioning of the stores needs to be done with utmost care taking into account the available stock, outstanding dues / supplies, the past consumption pattern, average life of the equipment / spares. The requirements also need to be properly clubbed so as to get the most competitive and best prices. The requirements should not be intentionally bifurcated / split so as to avoid approval from higher authorities.

In a case for purchase of 1,000 KVA D.G. sets, the tender enquiry was originally issued by the Organization for supply of D.G sets with four stroke engine. However, on the request of one of the bidders, the type of the engine was later changed from four-stroke to two-stroke and contract was awarded. During investigation, it was found that the engine manufacturer had given a release that the two stroke engine shall be phased out in two years. Surprisingly the existing DG Sets were with four-stroke engine.

In yet another case instead of buying DG sets for their energy needs, a shipyard hired DG sets from a firm in an ad hoc manner, without following competitive bidding. On investigation, it was revealed that the energy cost/ unit worked, in excess of Rs.40/-.

- One time purchase for projects or capital equipments / spares should be properly justified depending on the actual requirement usage, rate of return etc. Further, the obsolescence factor should also be taken into account i.e. the equipment to be purchased should conform to the latest specifications and technology available in the market.

Appointment of Consultants

Some of the organizations appoint consultants due to lack of in-house expertise in technical matters. It has invariably been noticed that the appointment of consultants is not being done in a transparent manner and their working is also not properly supervised.

- i. The appointment of consultants is often made in an arbitrary manner without inviting tenders and without collecting adequate data about their performance, capability and experience. In some of the cases, the consultants were appointed after holding direct discussions with only one firm without establishing the reasonableness of consultation fee payable to them. In some cases the terms were modified to the financial advantage of the consultant, even after award of the contract. In one of the cases, the organization continued with a consultant for about 30 years and for all types of contracts. In yet another case, the Organization invited offers from 8 enlisted consultants but, awarded the contract to the highest bidder on the plea that they are Padam Shree awardees. Extra amount on account of travel expenses was also sanctioned after award of the contract.

- ii. The payment terms to the consultants are allowed quite liberally. In one of the cases, the consultant fee was paid on quarterly basis without linking the same with the progress of the project. Even full payments had been authorized before the completion of the project.
- iii. Quite a few organizations especially in the Banking Sector seem to abdicate their responsibility completely and do not oversee the working of the consultants resulting in the latter exploiting the circumstances and at times in collusion with the suppliers, give biased recommendations in favour of a particular supplier. It has also been noticed that the consultants recommend acceptance of inferior items / equipments and also give undue benefit to the suppliers like non recovery of penalties, for the delayed supplies and corresponding reduction in the excise duty / custom duty, if announced after award of the contract.
- The consultants need to be appointed only when it is felt absolutely essential. The appointment of consultants needs to be done in a transparent manner and after following the competitive tendering system. The consultant's role should be well-defined. The consultant is meant to assist the departmental officers because of lack of expertise and, it should not mean that they takeover all the functions. The responsibilities relating to award of contract and execution of contract after appointment of consultant should not be abdicated completely by the organizations. Rather appropriate checks should be exercised at all stages of the execution of the contract. Penal clauses for deficiency in service should invariably be stipulated in the contracts/MOUs with the consultants.

Estimated Rates

It was observed that the estimated rates are being worked out in an unprofessional and perfunctory manner, at times by extrapolating the price of the lowest capacity equipment or by applying a uniform yearly compounded escalation over the prices of similar equipment purchased few years ago. Consequently, the inflated estimated rates prepared by the Organizations resulted in acceptance and payment of higher prices to the firms.

- As the estimated rate is a vital element in establishing the reasonableness of prices, it is important that the same is worked out in a realistic and objective manner on the basis of prevailing market rates, last purchase prices, economic indices for the raw material/labour, other input costs, IEEMA formula, wherever applicable and assessment based on intrinsic value etc.

Notice Inviting Tender

Against the most preferred and transparent mode of Global tender enquiry/Advertised tender enquiry, some of the Organizations are generally issuing limited tender inquiry to select vendors, irrespective of the value of purchase. Further, the credentials of the firms and the criteria adopted for selection of such vendors, in most of the cases, are not put on record. This not only results in lack of competition but also favoritism to the select vendors. It has been noticed that even in cases where Advertised/Global tender inquiries were issued, the same were published in the local dailies and not in any National Newspaper and particularly in Indian Trade Journal, Calcutta, which is a Government publication and is regarded as the standard medium for advertising tender notices in India. The main purpose of issuing Advertised/Global tender inquiry is to give wide publicity. It has been noticed that the Organizations do not forward the

copies of the tender notices to the registered/past/likely suppliers and while in case of imported stores, the copies of the tender notices are not being forwarded to Indian Missions/Embassies of major trading countries.

- In order to give wide publicity, generate enough competition and to avoid favoritism, as far as possible, issue of Advertised/Global tender inquiries should be resorted to and published in ITJ and select National Newspapers. The copies of the tender notices should be sent to all the registered/past/likely suppliers by UPC and also to the Indian Missions /Embassies of major trading countries in case of imported stores.

It has also been noticed that for Advertised/Global tenders, against a normal time of four - six weeks, there are instances wherein time for tender opening of only 12 - 15 days was given. Similarly, in case of limited tenders, against a normal time of 21 - 30 days, there are cases where tenders were opened in a short period of only 7 days. The tender opening in such a short duration is normally resorted to in case of recorded emergencies, where in the purchaser sends the tender inquiries by faster means like fax/speed post. However, in most of such cases, neither urgency nor the proof of having sent the inquiries by fax/speed post could be established. In few cases, it was also noticed that though short term tenders were invited, expressing urgency of the requirement, however, the cases were processed in a very routine and casual manner without any consideration for urgency. On the other hand, in some cases, it was noticed that with the short time available, only 2 - 3 vendors who probably knew about the system, submitted their bids and, thereby forming a cartel and circumventing the system. In some of the cases of Global tenders, it was observed that though the Organizations had given a time of 6 - 8 weeks for tender opening but the tender sale was closed 2 - 4 weeks in advance of tender opening, thereby effectively giving only one month time to bidders for purchase of tender documents. The very purpose of floating Global tender which is to give wide publicity and sufficient time to bidders to get the bidding documents and submit their offers, in such cases seems to have been defeated.

- With a view to have wider, fair and adequate competition, it is important that sufficient time of say 4 - 6 weeks in case of Advertised/Global tenders and 3 - 4 weeks in case of limited tenders is allowed, except, in cases of recorded emergencies, wherein also, a reasonable time should be permitted and tenders should be sent by faster means like speed post /fax. The tenders should preferably be kept open for sale till the date of tender opening or just one day prior to the date of tender opening. With the widespread use of Information Technology, the tender notices should also be put on the website and e-mail address of the organization should be indicated in the tender notice.

In case of proprietary purchases, the detailed justification for purchase from a single vendor is not being placed on record. As by issuing single tender, the competition is totally eliminated and the possibility of paying higher prices cannot be ruled out.

- It is imperative that the purchase on Single tender basis be made with the detailed justification in its support and with the approval of Competent Authority, including associated finance.

Tender/ Bid Document

The terms and conditions being stipulated in the bid documents by some of the Organizations are quite insufficient and sketchy. Sometimes, the bid document contain obsolete, unwanted matter and conflicting and vague provisions, resulting in wrong interpretation, disputes and time & cost overruns. Even the time/date for receipt and opening of tenders is not being incorporated in the documents. The important clauses relating to Earnest money, Delivery Schedule, Payment terms, Performance/Warranty Bank Guarantee, Pre-despatch inspection, Arbitration, Liquidated Damages/Penalty for the delayed supplies and Risk- purchase etc. are not being incorporated in the bid documents. All these clauses are important for safeguarding the interest of the purchaser and also have indirect financial implications in the evaluation of offers and execution of the contracts.

- All the important clauses as brought out above need to be incorporated in the bidding documents so as to fully safeguard the interest of the Government and, for evaluation of bids on equitable and fair basis and in a transparent manner.

In some cases, it was noticed that the amount of Earnest Money Deposit stipulated in the tender document was grossly insufficient to protect the Government interest in case of breach committed by the bidder. Some of the organizations instead of ignoring the bids not accompanied with earnest money deposit along with the tenders as per bids requirements, asked the bidders to submit EMD, after tender opening.

- The primary objective of submission of Earnest Money Deposit is to establish the earnestness of the bidder so that he does not withdraw, impair or modify the offer within the validity of the bid. It also helps in restricting if not eliminating 'speculative', 'frivolous' or 'wait and see' bids. Since any relaxation regarding submission of Earnest Money Deposit has financial implications besides giving encouragement to the bidders to submit frivolous bids as indicated above; the terms & conditions should clearly stipulate that the offers without Earnest Money Deposit would be considered as unresponsive and rejected.

In case of tenders invited in Two-bid system, some of the Organizations stipulate Earnest Money Deposit as percentage of the tender cost instead of fixed amount. In the Two-bid system, if EMD is taken on the basis of some stated percentage of tender value and with the announcement of the amount of EMD submitted by the bidders at the time of tender opening, the same will give every bidder a good indication of the prices quoted by the competitors by making back calculations. A bidder can use this information to the disadvantage of his competitor, if prices are subsequently modified.

- The Earnest Money Deposit in case of Two-bid system needs to be incorporated as a fixed and reasonable amount on the basis of estimated value of the purchase.

Some of the organizations incorporate a specific delivery schedule inter- alia mentioning that bids offering delivery beyond stipulated date will be treated as non-responsive and will be summarily rejected. However, after opening of the tenders, the bid by one of the organizations with slightly longer delivery period was not rejected as per the bid guidelines, rather that offer was also considered and evaluation was made after loading the offer by applying some unilateral loading criteria. The same resulted in inter se change of ranking position.

- In order to meet the project requirement, it would be prudent to incorporate an acceptable range of delivery period with the stipulation that no credit will be given for earlier deliveries and offers with delivery beyond the acceptable range will be

treated as unresponsive. Within this acceptable range, for the purpose of evaluation, an adjustment per month say @ 2% could be added to the quoted prices of bidders offering deliveries later than the earliest delivery period specified in the bid documents.

The Evaluation/Loading criteria on account of acceptable range of deviations in the commercial terms and conditions viz. Payment Terms, Delivery period, Performance Bank Guarantee etc. is not being incorporated in the bidding documents. The evaluation of the offers is being made simply on the price quoted which is not in order. The comparative assessment of offers in true sense would be complete only if it is made on equal footing taking into account the financial implications for the deviations in terms and conditions, in line with unequivocal evaluation criteria specified in the bidding documents. In one of the cases, it was noticed that due to non-stipulation of payment terms in the tender documents, the bidders quoted prices based on varying advance payment. The offers were evaluated by the Organization simply on the quoted prices, even though L-1 bidder had asked for much higher advance payment in comparison to the L-2 bidder. As such, the evaluation done by the Organization was not on equitable basis as the payment of higher advance, evidently had, financial implications.

- The Evaluation / Loading criteria with respect to the important terms. Like Payment terms, Delivery period, Performance Bank Guarantee etc. having financial implications need to be specified in unambiguous terms in the bid documents so that the evaluation of bids after tender opening could be made in a transparent manner without any subjectivity.

Some of the Organizations incorporate only broad technical details instead of generic specifications with complete details of performance parameters and the technical evaluation criteria. At times the technical evaluation matrix is decided after opening of tenders and is kept confidential. In absence of the detailed specifications/technical evaluation criteria, the evaluation of offers on equitable basis and in a transparent manner would not be possible and would rather be prone to subjectivity in the decision-making. In one of the cases of hiring of coolers, the requirement was bifurcated into two categories viz. 'new cooler' and 'as good as new coolers'. Neither the quantitative requirement of each category of coolers nor the specifications had been indicated for the category of 'as good as new coolers'. Thus the description given was quite vague and susceptible to manipulation as it gave full leverage to the bidders to supply coolers of any vintage.

- The detailed generic technical specifications including performance parameters and the technical evaluation criteria, if any need to be specified in the bidding documents in unequivocal terms.

The exemptions/reservation of a particular item which normally apply to SSI units are not being specified in the tender notice / bid documents. The applicable purchase preference to public sector enterprises as per the guidelines circulated by Department of Public Enterprises is also not being incorporated in the bid documents leading to lot of complaints from SSI/PS Units.

- The Government instructions on reservation of items and price preference to SSI Units and purchase preference to PSUs need to be incorporated in bid documents.

It has been noticed that some tenderers offer conditional discounts for coverage within a shorter period, for early inspection/ payment etc. and, such discounts are being considered, at the time of evaluation of tenders by the organizations.

- It needs to be ensured that the evaluation of tenders should not be based on such conditional discounts and suitable clause should be included in the bidding documents.

Receipt of Tenders

Some of the organizations do not have proper arrangement for receipt of tenders. There is no tender box for receipt of tenders at scheduled date and time fixed for tender opening. Instead the trade representatives leave the tenders with the receptionist or the concerned Purchase Officer(s). This procedure is highly objectionable as the possibility of tampering and interpolation of offers cannot be ruled out.

- A proper arrangement for receipt of tenders at scheduled date and time through tender box needs to be adopted.

Postponement of Tender Opening

Wherever extension in the tender opening is done due to reasons like change in the specifications or on the basis of request of the vendors, it has been noticed that firstly, sufficient time to submit the bids as per the revised specifications and secondly, the intimation of tender opening extension is not

being sent to all the bidders who had purchased the bidding' documents. Also such notice of extension is also not being published in newspapers / ITJ.

- In order to give equal opportunity to all the bidders and to maintain sanctity of tendering system, it is of paramount importance that any change in the tender terms & conditions, specifications and tender opening date etc. be notified to all the bidders, sufficiently in advance of the revised tender opening date.

Opening of Tenders

Some of the organizations are not opening the tenders in public i.e. in presence of the trade representatives. The system of not opening the tenders in public is against the sanctity of tender system, and is a non-transparent method of handling tenders. There could be a possibility of tampering and interpolation of offers in such cases. The rates at times are not quoted in figures and words, cuttings / over-writings are not attested by bidders. Some of the organizations justify such opaqueness in tendering system by making a reference to their manuals. This is not acceptable.

- The opening of tenders in presence of trade representatives needs to be scrupulously followed. While, opening the tenders by the tender opening officer / committee, each tender should be numbered serially, initialed and dated on the first page. Each page of the tender should also be initialed with date and particularly, the prices, important terms & conditions etc. should be encircled and initialed in red ink by the tender opening officer / committee. Alterations in tenders, if any, made by the firms, should be initialed legibly to make it perfectly clear that such alterations were present on the tenders at the time of opening. Wherever any erasing or cutting is observed, the substituted words should be encircled and initialed and the fact that such erasing / cutting of the original entry

was present on the tender at the time of opening be also recorded. The tender opening officer / committee should also prepare 'on the spot statement' giving details of the quotations received and other particulars like the prices, taxes, duties and EMD etc. as read out during the opening of the tenders.

Further, in case of 'Two bid' system, it has been noticed that after opening of the technical bids, the price bids, which are to be opened subsequently, are kept as loose envelopes. In such cases, the possibility of change of bids prior to tender opening cannot be ruled out. In order to make the system fool proof, it needs to be ensured that not only the tender opening officer / committee should sign on the envelopes but the signatures of two trade representatives should also be obtained on all the envelopes containing the price bids. Thereafter, all the envelopes should be put in a bigger envelope / box and the same should be properly sealed duly signed by the tender opening officer committee and trade representatives.

Post Tender Negotiations

As per CVC guidelines circulated vide letter No. 8 (1) (h) / 98 (1) dated 18.11.98, it has been brought out that "the tenders are generally a major source of corruption. In order to avoid corruption, a more transparent and effective system must be introduced. As post tender negotiations are the main source of corruption, post tender negotiations are banned with immediate effect except in the case of negotiations with L-1 (i.e. lowest tenderer)". In continuation to these instructions, following further clarifications were issued vide letter No. 98 / Ord. / 1 dated 15.03.99 :-

- (i) The Government of India has a purchase preference policy so far as the public sector enterprises are concerned. It is clarified that the ban on the post tender negotiations does not mean that the policy of the Government of India for purchase preference for public sector should not be implemented.
 - (ii) Incidentally, some organizations have been using the public sector as a shield or a conduit for getting costly inputs or for improper purchases. This also should be avoided.
 - (iii) Another issue that has been raised is that many a time the quantity to be ordered is much more than L- I alone can supply. In such cases, the quantity order may be distributed in such a manner that the purchase is done in a fair, transparent and equitable manner.
- Despite the above instructions, it has been noticed that still repeated negotiations with the selected/all the vendors are being carried out by some of the organizations in gross violation of the above instructions. The instructions/ guidelines circulated by CVC on post-tender negotiations only with L-1 need to be strictly followed.

Technical Evaluation of Tenders

Apart from the deficiencies already brought out in para 7.9, it has been noticed that though the offers of some firms fully conform to the specifications laid down in the bid documents, however, based on certain additional features which were never part of the specifications, the offers were graded as 'good', 'better' and 'best' for award of contract.

- Once it has been established that the offers meet the laid down specifications, the question of 'grading' as well as any 'pick and choose' should not arise. The

contract needs to be awarded to the lowest bidder meeting the laid down specifications.

Purchase Preference to Public Sector Enterprises

The Department of Public enterprises, Ministry of Industry vide OM No. DPE/ 13 (19) / 91-Fin. Dated 13.01.92, 15.03.95, 31.10.97, 10.02.98 and 14.09.2000 have circulated the policy of granting purchase preference to Central Government Public Sector Enterprises when they compete with Private large scale units. It has been laid down that where the quoted prices of Public Sector Enterprises or Joint Ventures with PSEs with a minimum value added content of over 20% by the latter, subject to purchase in excess of Rs. 1 crore, is within 10% of the lowest price, other things being equal, purchase preference will be granted to the Public Sector Enterprises or Joint Venture concerned at the lowest acceptable price. It has been noticed that some of the organizations are not following these instructions and accordingly, undue favour is being given to the Private firms.

- The instructions / guidelines circulated by Department of Public Enterprises for granting purchase preference to the Central Government, Public Sector Enterprises / Joint Ventures need to be scrupulously followed as also brought out by CVC in the instructions circulated vide letter No. 98 / Ord. / 1 dated 15.03.99.

Consideration of Indian Agents

It has been noticed that some of the organizations entertained the offers of Indian Agents and also place the contracts on them without bothering to examine the following aspects:-

- i. Foreign Principal's proforma invoice indicating the Commission payable to the Indian Agent, nature of after sales service to be rendered by the Indian Agent.
 - ii. Copy of the agency agreement with the foreign principal and the precise relationship between them and their mutual interest in the business.
 - iii. The enlistment of the Indian Agent with Director General of Supplies & Disposals under the Compulsory Registration Scheme of Ministry of Finance.
- The above aspects are important one to examine the genuineness of the prices quoted by the Indian Agent, the nature of services which would be available from Indian Agent and compliance of Tax Laws by the Indian Agent and, to prevent leakage of foreign exchange.

Reasonableness of Prices

It has been noticed that the purchases are being made by some of the organizations in an adhoc and arbitrary manner without satisfying the prime requirement of establishing the reasonableness of rates in relation to the estimated rates, last purchase prices or the prevailing market rates. Some of the instances are as under: -

- i. An organization placed an order for spares on a trader at an abnormally high price of about 40 times the OEM's price. In yet another case, in a span of 10 days, the order was placed on the same firm for the same item at rates almost 10 times of the previous order.
- ii. In another case for procurement of an ore crusher, out of 6 offers received by the organization, 5 offers were rejected mainly on the basis of unspecified technical

requirement, presumptions and conjectures. Therefore, the competition was killed. The prices of single left out offer were justified by extrapolating the prices of a lower capacity crusher (which were worked out by taking 5% compounded annual escalation over 10 years old prices) in proportion to the crushing force.

- iii. In yet another case for hiring of coolers, orders were placed for ambiguous categories of items like 'new' and 'as good as new' coolers. An order was placed on a firm for the category for which the firm had not quoted in their original offer but had subsequently quoted, after they were invited for negotiations. Despite the firm lacking in technical and financial capability and there being cartel formation, still the order was placed at exorbitant prices in comparison to earlier prices for a period of 3 years. Knowing well the cartel of firms and exorbitant prices, the department did not consider placement of order only for one year as for next two years, fresh tenders could have been invited to break the cartel and get better prices.
- It is very important to establish the reasonableness of prices on the basis of estimated rates, prevailing market rates, last purchase prices, economic indices of the raw material / labour, other input costs and intrinsic value etc., before award of the contract.

Advance Payment & Bank Guarantees

- (i) As per CVC guidelines circulated vide Office Memorandum No. NU/ POL/19 dated 08.12.97, it has been brought out that payment of mobilization advance should be made only in cases of select works and that the advance should be interest bearing so that the contractor does not draw undue benefit. However, it has been noticed that some of the organizations are quite liberal in allowing the advance payments even to the extent of 30-40% and that too, totally interest free. In some organizations the payment of advance is being stipulated in the bid document itself. The payment of interest free advance is in contravention of the guidelines issued by CVC.
- (ii) It has been observed that in some cases, despite provision in the contracts for releasing advance payment against Bank Guarantee, the advance payments were released without taking any Bank Guarantee. Unfortunately, in some of the cases, the suppliers failed to discharge their contractual obligations and huge advances are still outstanding for the last several years. It would be suicidal, if the advance payment is released without the Bank Guarantee for an equivalent amount.
- (iii) In some cases, it has been observed that though the prospects of supply were bleak, still timely action for revalidation / encashment of the Bank Guarantee for the advance payment was not taken and the Bank Guarantees were allowed to lapse, jeopardizing the Government interest. In one of the cases, though the initial advance payment of 20% was released against the Bank Guarantee, however, further 65% progressive payments were also made simply against certification of Internal Auditors that the amount claimed does not exceed the progressive expenditure. The payments were made in a span of hardly 2 months much before the bulk production clearance and without safeguards like Bank Guarantee etc. The Bank Guarantee for 20% initial advance payment was also allowed to lapse. Thereafter, the firm did not make any supplies and was declared

sick and huge Government claim towards the advances made without protecting the Government interest remain un-recovered.

- (iv) The Bank Guarantees accepted were at times defective/conditional and did not safeguard the interest of the purchaser. Normally, the BGs permitting encashment without any demur - merely on a demand from the purchaser are accepted. However, in some cases, though the Bank Guarantees submitted by the suppliers were conditional, stipulating "the encashment only if it is established the supplier had failed to comply with his contractual obligations," but, the same were accepted. In one of the cases for procurement of high value equipment, it was observed that though for release of initial advance payment of 30%, submission of a Bank Guarantee was stipulated but, surprisingly for further progressive payments up to 50%, which were also in the form of advances (without receipt of the equipment), the reimbursement of payment simply on the basis of a 'Certificate of Assignment' and without any BG was authorized. After release of first 30% progressive payment, BG taken for 30% advance payment had automatically expired as per terms of the BG. Evidently in this case, the BG was not examined properly before acceptance and the defective BG having conditions deterrent to the Government interest was accepted.
- (v) In some cases, it was noticed that the effective date of contract was linked with the date of receipt of Bank Guarantee for advance payment. This is detrimental to the purchaser's interest as in the absence of a specific date for submission of Bank Guarantee, it would not be possible to establish specific date of breach to enforce the contractual remedies. In such cases, the supplier will get full opportunity to wriggle out of the contract, if he so desires without fulfilling contractual obligations.
- The advance payments need to be generally discouraged except in specific cases. Wherever payment of advance is considered unavoidable, the same should be interest bearing as per CVC guidelines and be allowed after getting an acceptable Bank Guarantee for an equivalent amount with sufficient validity so as to fully protect the Government interest. Some reasonable time should be stipulated for submission of Bank Guarantee so that contractual remedies could be enforced, if required. The Bank Guarantees need to be properly examined with respect to the acceptable format and any conditions deterrent to the Government interest should be got withdrawn before acceptance besides verifying the genuineness of the Bank Guarantees from the bankers. Timely action for revalidation / encashment of the Bank Guarantees also needs to be taken so as to protect the Government interest.

Performance Bank Guarantee

Most of the organizations are not stipulating the requirement of Performance Bank Guarantee while others are stipulating different amount of Security deposit / Performance Bond. In some cases, it has been noted that the amount of PBG is too low in comparison to the contract value. The validity of Bank Guarantees is also not being scrupulously monitored and the extension in the Bank Guarantees commensurate with the delivery period extensions is not being sought resulting in loss to the Government in the event of nonperformance of the contract.

- In order to safeguard the Government interest, it would be appropriate to take reasonable amount of Performance Bank Guarantee valid up to warranty period

for due performance of the contract. The validity of the Bank Guarantees needs to be carefully monitored and whenever extension in the delivery period is granted, the validity of Bank Guarantee should also be appropriately extended so as to protect the Government interest. The genuineness of the BGs should be checked from the issuing bank.

Stipulation of delivery period in the contract

Delivery period is the essence of any contract. It has been observed that in some of the cases, specific delivery period with reference to the terms of delivery is not being incorporated as mentioned below: -

- i. Only the date of offering the equipment for Pre-despatch inspection is stipulated as the delivery period, though the terms of delivery are on CIF basis/ FOR destination basis.
 - ii. Only the date of completion of supply of the equipment is stipulated as the delivery period even though the installation & commissioning of the equipment is also to be carried out by the supplier. For installation & commissioning, no specific date is stipulated. In absence of any contractual binding in this regard, the suppliers claim the full payment for supplies of equipments and then tend to behave in an irresponsible manner and do not bother to take up timely installation / commissioning resulting in the equipment remaining uninstalled for months / years together.
- The specific delivery period for supply as per the terms of delivery such as FOR station of despatch / destination and for completion of installation with the necessary provision for Liquidated damages / Penalty clause in the event of delay in supplies/ installation needs to be incorporated in the contract.

Guarantee / Warranty Terms

The guarantee / warranty clause incorporated by some of the organizations is quite sketchy. The modalities for enforcing the warranty obligations are not being incorporated. Due to incomplete guarantee / warranty terms, the suppliers take full leverage and do not bother to honour the guarantee / warranty obligations resulting in the equipment remaining defective and unutilized and thereby causing loss to the Government. It has been observed that in cases where the installation of the equipment is also included in the scope of contracts but the standard guarantee / warranty clause of 15 months from the date of shipment / despatch or 12 months from the date of delivery, whichever is earlier is being incorporated. With the result due to delay in installation of the equipment, the guarantee / warranty expires even before the installation of the equipment or sometimes a very short period of guarantee / warranty is available.

- Detailed guarantee/warranty clause embodying all the safeguards be incorporated in the tender enquiry and the resultant contract. It also needs to be ensured that in installation/commissioning contracts, the guarantee/ warranty should reckon only from the date of installation/ commissioning.

Post-contract Management

Modification of contract terms / specifications

After award of the contract, amendments/modifications having financial implications are authorized in the contract terms/specifications giving undue benefit to the suppliers. Some of these are enumerated below:-

- i. The specifications are diluted e.g. though specific makes/models of an equipment are specified in the contract as per firm's tender, however, subsequently supply of some more alternative makes/models of the equipment are authorized without taking into account the financial implications thereof. It has been observed that generally lower priced alternative makes/models are being included subsequently in the contract giving undue benefit to the supplier.
- ii. The payment terms are amended favourable to the supplier e.g. advance payments are authorized even when there was no provision in the contract for making advance payments. At times higher advance payments than stipulated in the contract are authorized.
- iii. The Pre-despatch inspection though was incorporated in the contracts but, the same was subsequently waived without any reasons, thus jeopardizing the quality aspects as per contractual requirement.
- iv. The submission of Performance Bank Guarantee was waived.
- v. Even though the contracts were placed on FOR destination, the locations of the consignees were changed nearer to the supplier's premises without taking into account the benefit of freight charges.

• After conclusion of the contract, any relaxation in the contract terms / specifications should be severely discouraged. However, in exceptional cases where the modifications/amendments are considered to be absolutely essential, the same should be allowed after taking into account the financial implications for the same.

Post-contract Monitoring

- i. The post contract monitoring is being handled in a very casual and lackadaisical manner. It has been noticed that due to lack of coordination and diversified approach followed by various agencies in the implementation of the projects the same resulted in time and cost over-runs.
- ii. It has been noticed that in some cases even after expiry of delivery schedule stipulated in the contract and without extension of time granted by the purchaser, the consignees keep on exchanging correspondence with the suppliers and thereby keep the contract alive. This may result in serious legal complications if it is intended to cancel the contract. It has also been noticed that even the materials are being accepted and payments are released as and when the supplier makes the supplies. There is utter disregard to the contracting norms relating to delivery period, which is the essence of the contract.
- iii. Generally, the purchaser extends the delivery period of the contracts. However, in some cases it was recorded that the 'Supplier' has extended the delivery period of the contract.

- iv. Some of the organizations do not incorporate Liquidated damages / Penalty clause for imposing the penalty in case of failure of the suppliers to deliver the equipment within the stipulated schedule. The suppliers quote short delivery period and in absence of deterrent conditions in the contract, manage repeated extensions. In some of the cases, it has been observed that Liquidated damages for delay in supplies are not being levied and recovered from the suppliers.
- v. It has also been noticed that although there had been delay attributable on the part of the supplier in making the timely supplies, however, the organizations are extending the letter of credit with the proviso that the L/C extension charges shall be borne by the organization, thereby giving undue benefit to the suppliers.
- It is essential to accord priority to the post contract follow up. The delivery period should be extended on bonafide request and not in a routine and casual manner. After expiry of delivery period, the consignees should be refrained from exchanging correspondence with the supplier. In case of delay in supplies by the supplier, the liquidated damages to the extent possible need to be recovered. Also in case of delay attributable on the part of the supplier, the L/ C extension charges should be to supplier's account. In nutshell, there is a need to discipline the suppliers so that the non-performers could be weeded out and the suppliers which can be relied upon with consistent performance, in terms of quality and delivery schedule are encouraged.