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The articles in the journal have been written keeping in view the clients served by this Institute, the cuting edge of audit namely Audit Officers and staff of the IA&AD . This volume has articles on practical auditing and on the evolution of some well known principles of audit.

I thank the contributors and others who helped in publishing this volume.

Ashutosh Joshi
Director General
RTI, Jaipur

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Chapter 1

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Conducting effective financial audit of Central/State Public Sector Undertakings / Autonomous Bodies.

(Continued from second edition of Focus; RTI Journal)

(This article has been penned by Shri Brijeshwar Prasad Tripathi, Senior Audit Officer, O/o- the Principal Accountant General (Audit-II) Uttar Pradesh, Lucknow. He has used his knowledge and experience gained nationally and internationally to present systemically arranged guidance material for conducting effective financial audit of the Central/State Public Sector Undertakings (PSUs)/ Autonomous Bodies (ABs). This material provides a practical approach to the audit of Annual Financial Statements(AFSs). This material has already been used in imparting online trainings by him to the participating officers of Civil and Commercial streams, through RTI, Jaipur and RTI, Prayagraj. The key feature is the Comprehensive Top-down Drilling Approach (CTDA) evolved by Shri B P Tripathi for systematic and comprehensive audit of Annual Financial Statements

The material is presented in four sections:

1. Basic Inputs-Learning objectives, types of financial audit, types and constituents of the financial statements, etc.
2. Start to End Audit process including Comprehensive Top-down Drilling Approach (CTDA)
3. Framing, classifying, drafting and reporting the comments, with illustrative structures
4. Interesting Case Studies based on actual audits

In this edition of our Journal, we bring you the fourth section of the article)

Section IV

Interesting Case Studies based on actual audits

In the previous three segments of the article "Conducting Effective Financial Audit", a practical approach and audit techniques to identify and unearth the inadvertent as well as the managed errors i.e. 'window dressing' in the Annual Financial Statements (AFSs); and how to draft a "to-the point and easily understandable comment" have been discussed. In this segment, certain interesting case studies (ICSs) pertaining to international audit assignments and national audit assignments have been brought out.

It may be a general curiosity amongst the readers who have gone through the aforesaid segments of the article, as to how the effective financial audits have been conducted in actual scenario by applying the "Comprehensive top-down drilling approach (CTDA)" evolved by the writer and discussed in the earlier segments of this article. It is pertinent to mention that the writer of the aforesaid article has conducted various financial audits (national and international), which among others, include the financial audits of UNICEF and FAO conducted in the recent past. Further, besides processing and finalisation of comments on the

accounts after their audit, the writer being a member to the Technical Support Cell (TSC) formed in his office, has also provided opinion on the critical accounting cases referred to the TSC from time to time. Therefore, under the current segment, an attempt has been made to embellish the article with the ICSs based on the actual audits conducted, and processing/finalisation of comments on the accounts, including one or two cases of TSC opinion. However, wherever required for the purpose of confidentiality, instead of using the actual name of the concerned organisation, especially in case of national audit assignments, certain indicative references have only been made in this segment. Further, these ICSs have been presented majorly under two categories viz. international audit assignments and national audit assignments.

Presently, the CAG of India has been entrusted with the audits of FAO (2020 to 2025), WHO (2020-2023), IAEA (2022-2027), OPCW (2021-2023) and IPU (2020-2022). Keeping in view the fact that the case studies pertaining to the international audit assignments may provide an insight and be helpful in conducting the financial audits of these organisations, certain very important cases pertaining to the international audit assignments have been discussed first as under:

A. ICSs pertaining to international audit assignments

Financial audit of FAO for the year 2021

Brief Introduction

The Food and Agriculture Organisation (FAO) headquartered at Rome in Italy, prepares its Annual Financial Statements (AFSs) for a calendar year ending on 31 December as per the applicable International Public Sector Accounting Standards (IPSASs). FAO has adopted IPSASs since 2014. Prior to adoption of IPSASs, the AFSs of FAO were being prepared as per the United Nations System Accounting Standards (UNSASs). The FAO carries out the accounting transactions and maintains the accounting records under the four categories of funds namely General Funds (GF), Trust Funds (TF), UNDP funds (UN) and other funds (OT). The main sources of revenue of FAO are assessed contributions (ACs) and voluntary contributions (VCs) being received from the member nations/countries and other international organisations viz. UNDP, World Bank etc. The ACs and VCs are termed as non-exchange revenue under the IPSASs.

ICS-1: Recognition of revenue from VCs

Audit criteria

Provisions of IPSAS 23 indicate that, in cases where the VCs are unconditional in terms of the stipulations mentioned in the respective donor agreement (DA), the revenue from VCs committed in a DA will be recognised on the date when the DA becomes binding/enforceable i.e. on the date of signing of the DA or any subsequent date of enforcement mentioned in the DA, regardless of the term of payment of these VCs, falling within the year of signing of DA or spreading in the subsequent years. The term of payment spreading in more than one year indicates the multi-year VCs/DA.

The aforesaid provisions also indicate that, in the cases where the VCs are conditional, in terms of the stipulations mentioned in the respective DA, these VCs

are recognised as 'Deferred revenue', treating the same as liability until the associated conditions are fulfilled.

Accounting policy Vs. Accounting practice: FAO has formulated the accounting policy for recognition of non-exchange revenue in line with the provisions of IPSAS 23. However, it had adopted a discrepant accounting practice which was in violation of the provisions of IPSAS 23 and its own accounting policy for recognition of revenue from the VCs. This discrepant accounting practice had been applied by FAO since adoption of IPSASs in 2014.

Audit clue: During training provided by the FAO to the Audit Team (writer also being the team member) entrusted with the work of audit of AFSs of FAO for the year 2021, a query was raised by the writer. In the response, FAO indicated that the revenue from the VCs was recognised on the date of invoice raised to the respective donor, only to the extent of amount of VC mentioned in the invoice, regardless of date of enforcement of the respective DA and the VCs committed therein. The said response provided an audit clue to work thereon. Further, during audit, FAO's aforesaid response was test-checked, and the discrepant accounting practice being applied by FAO for recognition of revenue from VCs was confirmed in writing. Now the sky spreading audit scope was open to work hard and frame the daring audit observation, which of course, was to route through the audit process generally applied in international audit assignments viz. issue of audit requisition (ARs), audit queries (AQs) followed by discussions with the FAO management, and issue of audit observations (AOs).

Audit observation: As mentioned in the preceding paragraphs, the FAO had been recognising revenue from the VCs, as per the discrepant accounting practice applied by it since the adoption of IPSASs in 2014. Accordingly, a portion of the VCs committed in the respective DA was recognised in a year and remaining portion thereof was being recognised in subsequent one or more years, despite the fact that the whole amount of VCs committed in the respective DA was to be recognised on the date when such DA became binding, in case of unconditional VC/DA.

As the number of DAs were more than 3000, about 40 cases of VCs with money value of USD 10 million or more in each case were selected for audit scrutiny. The scrutiny revealed non/short recognition of revenue from the VCs in the year in which these were to be recognised, in terms of the provisions of IPSAS 23 and the accounting policy of FAO for recognition of non-exchange revenue. Accordingly, an amount of USD 133 million was pointed out as the non/short recognition of revenue from VCs in the year 2021, which constituted to 85 percent of the surplus depicted in the Statement of Financial Performance (Profit and Loss Account) for the year ending on 31 December 2021. Therefore, it was recommended that FAO management:

(i) review its existing accounting practice for recognition of revenue from non-exchange transactions (voluntary contributions), though adopted consistently since 2014, as it is in contravention to the accounting policy stated in Note 2.48 to the AFSs 2021 and the applicable provisions of IPSAS-23.

(ii) Take appropriate action to recognise the revenue from voluntary contributions in compliance with its accounting policy stated in Note 2.48 to the AFSs 2021 and the applicable provisions of IPSAS 23.

(iii) Reflect fair financial results i.e. surplus for the year 2021 and the Financial Positions as on 31 December 2021 along with the required restatement of comparative figures for the year 2020.

Response of FAO management: FAO management, in response to AQ, did not agree to the audit observation, stating that the aforesaid accounting practice had consistently been applied since adoption of IPSASs in 2014, which was not objected to earlier. However, after discussion, they agreed to the observation and in response to the AO, assured to review the accounting of revenue recognition from the VCs since the year 2014.

Impact of audit: FAO management reviewed the accounting of revenue recognition from the VCs form the year 2014 to 2021, and the AFSs 2021 provided to the Audit Team for audit were substantially revised. The revised AFSs reflected recognition of the remaining portion of revenue from the total VCs committed in the respective DA of unconditional nature. The aforesaid change in accounting treatment resulted in an increase of revenue recognised in 2021 by USD 277.4 million (22 percent) and increase in Retained Earnings (also known as Accumulated Surplus) by USD 1522.5 million as on 31 December 2020 (246 percent). Consequently, the Surplus for the year ending on 31 December 2021 was increased by USD 277.4 million (176 percent).

ICS-2: Discrepancies and non-reconciliation of figures of Cash Flow Statement 2021

Introductory: FAO prepares its Cash Flow Statement (CFS) under indirect method provided in IPSAS-2. The CFS is an integral and important part of the AFSs, which provides reconciliation and movements (inflow and outflow) of Cash and Cash Equivalents (CCE) as appearing in the Statement of Financial Position (Balance Sheet) as on the Balance Sheet date of the current year, and that appearing as on the Balance Sheet date of the previous year. Therefore, the figures taken in preparation of CFS are invariably derived from the finalized figures appearing in the Statement of Financial Performance (Profit and Loss Account) and Statement of Financial Position (Balance Sheet) and notes related thereto, which indicate the source-figures of movements done through operating activities, financing activities and investing activities, during a financial year i.e. from previous year to current year.

Audit criteria

Para128 of IPSAS-1 provides that each item on the face of the statement of financial position, statement of financial performance, statement of changes in net assets/equity and cash flow statement shall be cross-referenced to any related information in the notes.

Audit clue: From the prima facie perusal of the CFS 2021 as prepared by FAO, it was found that most of the figures depicted therein were not cross-referenced to the related information. It provided an audit clue that there may be issues relating to depiction of incorrect figures, and reconciliation of figures incorporated in the CFS with those appearing in other associated Financial Statements and notes

related thereto. Hence, the audit scope was clear that each item depicted in the CFS 2021 should be reconciled with the source-figures appearing in other associated Financial Statements.

Audit observation: The audit scrutiny revealed that, out of 22 items of CFS, figures taken in 15 items were not reconciled with those appearing in other financial statements and notes related thereto viz. Statement of Financial Position as on 31 December 2021 and Statement of Financial Performance for the year ended 31 December 2021 leading to a total difference of USD 21.44 million. Further, figures taken in three items of CFS could not be reconciled for want of cross-referenced note to other financial statements. The reason for non-reconciliation of figures and difference therein was apparent in the facts that out of 22 different items (excluding surplus/deficit) of CFS for the year ended 31 December 2021, only seven items were cross-referenced to Note 20 and 21 and the remaining 15 items had not been cross-referenced to the related notes. This was in non-compliance with the Para 128 of IPSAS-1. This not only indicated instances of depiction of one or more adjusted figures in the CFS just to reconcile the CCE depicted in the Statement of Financial Position, but also restricted the understandability of the users of the AFSs. Therefore, it was recommended that FAO management:

(i) review its existing practice for preparation of CFS in the light of Para 30 of IPSAS-2, and suitably revise the CFS for the year ended 2021, ensuring that the figures taken in CFS are derived from the source-figures appearing in the Statement of Financial Performance for the year ended 31 December 2021 and the Statement of Financial Position as on 31 December 2021/Notes related thereto.

(ii) cross-refer each item of the CFS 2021 to the related notes and if required, additional explanatory notes, in compliance with Para 128 of IPSAS-1.

Response of FAO management: FAO management, in response to AQ, did not agree to the audit observation, stating that they have been preparing the CFS in the same manner since long, which was not objected to earlier. However, after a warm discussion with the instances of CFS being prepared by other UN organisations given in support of the audit observation, FAO management agreed to carry out the required modification in the CFS to make depiction better and more understandable to the users.

Impact of audit: At the instance of audit, FAO management substantially revised the CFS 2021, each item was cross-referred to the related notes, and wherever required, additional explanatory note was also added below the CFS to indicate the linkage of the figures given therein with the source. Thus, the CFS 2021 was made more understandable.

ICS-3: Apparent discrepancies in presentation and disclosures in the AFSs 2021

Introductory: It is the primary and foremost important duty of an Auditor to derive a reasonable assurance that the facts and figures given in the AFSs do not normally contain any misstatement/error. Further, the Auditor must design the audit procedures and the strategies that enable him to detect and point out the discrepancies/errors/misstatements apparent on the face of the AFSs for their

correction. Performance of this act of an Auditor enhances the reliability on the facts and figures incorporated in the AFSs, including the results depicted therethrough.

Audit criteria

There should not be any apparent discrepancies/errors relating to totals, rounding off, and other facts and figures incorporated in the AFSs. Further, the facts and figures incorporated in the AFSs should be complying with the applicable IPSAS.

Audit clue: The preliminary perusal of the AFSs indicated totalling errors, discrepancies in notes, inadequate disclosure of facts, rounding errors etc. which were apparent on the face of the AFSs 2021.

Audit observation

The CTDA was applied and a thorough study of the AFSs 2021 was carried out by the writer of this article for ascertaining accuracy of the facts and figures and adequacy of their disclosure in the AFSs 2021. Accordingly, number of totalling errors/discrepancies in various notes and cases of inadequate disclosure of facts were noticed and pointed out, as discussed below:

Discrepancies relating to totals

The audit scrutiny of AFSs 2021 revealed discrepancies relating to totals in **1**. Statement of Changes in Equity **2**. Cash Flow Statement **3.** Statement of comparison of budget and actual amounts **4.** 31 December 2020 Comparative year Financial Statement Line item/balance affected statement (Note 2.62) 5. Note 10 (Intangible Assets) 6. Note 13.8 and 13.10 (Reconciliation of defined benefit obligation), and 21.5 (Finance Income and expenses) 7. Note 22.14 8. Note 22.16 (figures of equities) and 9. Note 22.16 (figures of non-equities).

Discrepancies in Notes to the AFSs 2021

Note 27

Note 27.1 to the AFSs 2021 provides that the Organization's reporting date is 31 December for the 2021 IPSAS Financial Statements. The financial statements were authorized for issue on 31 March 2022, the date at which they were submitted to the External Auditor by the Director General. On the date of approval and signing of these accounts, there have been no material events, favorable or unfavorable, incurred between the reporting date and the date when the financial statements were authorized for issuance that would have impacted these statements. Audit scrutiny revealed that the AFSs 2021 provided for conducting audit were not approved and signed by the competent authority. Thus, the disclosure made in note 27.1 was erroneous.

Note 2.62

The impact of restatement in the AFSs 2020 was mentioned as USD 20.0 million reduction in the surplus for the year and total equity as on 31 December 2020. However, the correct impact was an increase in surplus for the year and total equity as on 31 December 2020 by USD 17.7 million. There was a note under CFS 2020 for restatement of figures of CFS 2019, however, a similar note is missing under the CFS 2021for restatement of figures of CFS 2020.

Note 2.56: The word 'Internal' was used instead of the correct word 'International'.

Note 12.2: The previous year's figures corresponding to the amount of USD 331.3 million of 2021 was not mentioned.

Note 16.4: Provision of USD 690 for pending litigation cases depicted in Note 16.4 does not correspond to that worked out from Note 21.6.

Note 4.7*:* Against the unrealised gains of USD 143.3 million, period wrongly mentioned as 31 December 2020, instead of 31 December 2021 in Note 4.7.

Note 5.1*:* Against an increase of USD 5.6 million in the value of outstanding assessments on Member Nations, period wrongly mentioned as 31 December 2021, instead of 31 December 2020 in Note 5.1.

Note 20.7: Against the amount of USD 43.0 million, the corresponding year 2020 is missing in Note 20.7.

Note 2.59-2.60

Note 2.59 provides that the organization reviewed the accounting for cash transfers, other grants, and transfer payments. Note 2.60 provides that the impact of change in accounting policy as mentioned in Note 2.59 was a reduction in expenditure recognized for 2020 under Grants and other transfer payments of USD 20.0 million. Audit scrutiny revealed that there was no change in accounting policy. The accounting policy stated in Note 2.55 has been reiterated in Note 2.59. The above impact as mentioned in Note 2.60 was on account of correction of an error, and not change in accounting policy.

Inadequate disclosures

Note 2.1: An explicit and unreserved disclosure with respect to extent of compliance of IPSASs as required under Para 28 of IPSAS-1 had not been made.

Note:4.4: The aforesaid notes provide that the unrealised gains and losses on the 'available-for-sale investments' are recorded/recognised in the Statement of Financial Position. We understand that the aforesaid unrealised gains and losses are finally recognised in the Statement Financial Position, but these are initially routed through the Statement of Change in Equity. So, for better understanding, the facts mentioned in Note 4.4 should be *"the unrealised gains and losses on the 'available-for-sale investments' are finally recognised in the Statement of Financial Position* ***through the Statement of Change in Equity".***

Note 20.6

The above note does not provide complete breakup and details for Letter of Agreement (LoA) amounting to USD 158.10 million in 2021 and USD 169.07 million in 2020. Against these amounts, the breakup and details are available for an amount of USD 143.6 million and USD 149.7 million in 2021 and 2020 respectively.

Note 20.9

The above note does not provide complete breakup and details for Inventories distributed amounting to USD 213.21 million in 2021 and USD 203.58 million in 2020. Against these amounts, the breakup and details are available for an amount of USD 118.20 million and USD 118.70 million in 2021 and 2020 respectively.

Note 2.4

FAO depicted the amounts in thousand USD in the AFSs 2021, however, the level of rounding in "thousand' has not been disclosed in Note 2.4 as required under Para 65 of IPSAS-1. Further, there were inconsistencies in level of rounding for decimal places.

Response of FAO management: FAO management, in response to the AQs/AOs, agreed to carry out the required corrections/modifications. Accordingly, while revising the AFSs 2021, the aforesaid discrepancies/errors/inadequate disclosures,

together with non-disclosures of policy etc. were properly addressed to and corrected accordingly.

Impact of audit: The discrepancies/errors relating to totals, rounding off, facts and figures disclosed in the notes, and inadequate disclosures/non-disclosures etc. appearing in the pre-revised AFSs 2021 rectified. This indicated adequate and reasonable assurance that there were no apparent errors/discrepancies in the revised AFSs 2021.

Overall impact of audit: The aforesaid cases provide a glimpse of the audit of AFSs 2021. There were many other important observations pointed out by the writer and other members of the Audit Team. Keeping in view the observations touching almost each area of the AFSs and leading to substantial revision of the AFSs with increase in Surplus for the year 2021 by 176 percent and Retained Earnings by 246 percent, this financial audit was highly effective amongst the international audits conducted in the past.

Financial Audit of FAO Credit Union (CU) for the year 2021

Introductory

FAO CU established in 1954 is an integral part of FAO, which is operated by a Board of Directors under the authority of Director General of FAO as per the Statues and Byelaws. The primary purpose of establishment of the FAO CU is to encourage thrift by providing a convenient means of savings, and to provide credit for emergency needs and for the general benefit of its members. FAO CU is funded primarily by the savings deposited by the members. All costs incurred by the FAO CU and any financial liability or loss arising out of its activities are to be charged to the FAO CU's funds and reserves. FAO CU's Annual Financial Statements (AFSs) and related notes are prepared in accordance with the United States Generally Accepted Accounting Principles applicable to credit unions, namely Statement of Financial Accounting Standards (SFASs).

ICS-4: Annual Appropriation to the Statutory Reserves

FAO CU has established Statutory Reserves namely General Reserve, Liquidation Reserves and Loan Insurance Reserve under the authority provided in its Statues. It transfers amounts from unappropriated retained earnings to these Reserves annually as per the provisions of the Statues.

Audit criteria: As per the provisions of FAO CU's Statues, at the end of each financial year, ten percent of the amount resulting from the subtraction of all expenses except interest expense from all income shall be transferred in equal amounts from unappropriated Retained Earnings (REs) to the General Reserve, the Liquidation Reserve and Loan Insurance Reserve.

Audit clue: The preliminary perusal of AFSs of FAO CU 2021 revealed the possibility of observation in the methodology of calculation of annual appropriations to be made to these reserves.

Audit observation: As per the audit criteria mentioned above, the annual appropriations to the aforesaid Statutory Reserves were to be worked out @10 percent of (All Incomes- All Expenses except interest expense). The scrutiny of appropriations made to the aforesaid Reserves as depicted in the AFSs 2021 revealed that while calculating the annual appropriations to be made at the end of 31 December 2021, FAO CU had also deducted from all the incomes, the unrealised loss on investments, besides all expenses except interest expense. This methodology of calculation was not in line with the aforesaid formula stipulated in the FAO CU's Statues which is meant for protecting the adequate appropriation to

the Statutory Reserves out of the unappropriated component of Retained Earnings even in case of net loss in the Statement of Income and Expenses. Thus, adoption of the incorrect calculation methodology indicated understatement of appropriation to all the three Statutory Reserves by USD 76659 (89 percent) with overstatement of the unappropriated REs by the same extent at the end of 31 December 2021. Accordingly, it was recommended that FAO CU should review the matter and take appropriate action in compliance with the intent of the provisions of Section-3 of Article 5 of its Statues to protect the adequate annual appropriation to the Statutory Reserves, out of the unappropriated Retained Earnings, even when, there is net loss during a year.

Response of FAO CU management: FAO CU management did not agree to the audit contention at the stage of AQ and had a strong argument that the aforesaid calculation methodology had consistently been applied since long, which was in line with the provisions of the Statues. In response to the AO, they stated that the provisions of the Statues for calculation of annual appropriations to the Statutory Reserves are open to interpretation and they respect the interpretation shared by the audit. However, they would prefer to be consistent and keep with the interpretation as applied in previous years.

Finally, FAO CU management agreed to the audit contention when it was emphasised that intent of the provisions of the Statues should be considered prudently, and they agreed to revise their long back accounting practice, which was being consistently applied by them.

Impact of audit: FAO CU management was finally convinced with the interpretation of the provisions of the Statues with respect to annual appropriations to be made to the Statutory Reserves, as pointed out by the writer during audit. Considering the audit observations, which among others, included the above audit observation, FAO CU revised its AFSs 2021 substantially. Thus, the financial audit of FAO CU 2021 was also very effective which could be possible by application of the audit approach evolved by the writer.

ICSs pertaining to National Audits

ICS-5: This ICS pertain to a peculiar accounting strategy applied by a Central PSU (CPSU) to depict the high profitability in its AFSs. This case of indicative of window dressing done by the above CPSU, and the CTDA was used as a weapon to fight against the window dressing

Mystery behind the case: One can understand well of a PSU applying window dressing to manipulate profits, wherein, sharing of profit related pay (PRP) is applicable for the officers/employees.

Brief of the case: Notes to Accounts as well as 'Emphasis of matter' in the Independent Auditors' Report depicted that the Company had made a provision of Rs.227.68 crore for employee benefit costs in compliance with the provisions of Ind AS 19.

Source of doubt: There was generally no reason to disbelieve the aforesaid facts disclosed by the Company, and also affirmed by the Statutory Auditors. When the writer of the article compared the size of profit and business transactions during the year under reference, he had a doubt as to why the size of profit still maintained even after making provisions of Rs.227.68 crore.

The writer discussed this issue with the Chief Financial Officer (CFO) of the Company, who assured that there was nothing to doubt; and provisions of Rs.227.68 crore had been made in the accounts during the year. I applied my CTDA

and decided to examine the issue at the very root level of passing the Journal/adjustment entry. The writer asked for the Journal Entry voucher (JEV)/adjustment entry, if any passed for the above provisions to be shown. It is pertinent to mention that the accounts of the company had been prepared through SAP ERP system. No hard copy of JEV was, therefore, produced for two-three days. Still the writer continued pursuing the case rigorously

The writer insisted that the Journal/adjustment entry made in the SAP ERP system for the above provisions must be shown to him. It was highly surprising to note that a Journal entry for the provision of Rs.227.68 crore was made in the accounts on 31 March of that year in the SAP ERP system. Based on this entry, disclosures in the Notes to Accounts by the Company and in the Audit Report by the Independent Auditors were incorporated. However, to nullify this entry, there was another minus entry for the same amount made on the same day i.e. 31 March in the SAP ERP. This confirmed the doubt of the writer as to why the size of profit was not affected even after making provisions of Rs.227.68 crore in the accounts.

Impact of audit

CTDA proved that the disclosures by the Company as well as the Independent Auditors were wrong. Based on audit comments for non-provision in contravention to Ind AS-19; and incorrect disclosures, the Independent Auditors had to revise their Report.

ICS-6: Unreasonable change of a reasonable opinion by the Statutory Auditors

Brief of the case: Statutory Auditors appointed by CAG of India for audit of accounts of a Company for the period of four consecutive financial years, had expressed an adverse opinion (The financial statements do not present a true and fair view) on the first year's accounts, based on their comments. There was no compliance with the comments of the Statutory Auditors. All the accounting issues raised earlier existed in the subsequent two years' accounts audited by the same Statutory Auditors. However, in these years, the Statutory Auditors had changed their opinion and made a qualified opinion instead an adverse opinion, without any change in the bases of opinion expressed earlier.

The writer applied his CTDA and examined all the previous Audit reports of the same Statutory Auditors in relation to the audit of the accounts of the company for a consecutive period, audited by them to establish the unreasonable change of opinion. CTDA brought out how an unreasonable change of a reasonable opinion has been made by the same Statutory Auditors.

ICS-7: The apparent non-compliance by a central PSU of Insurance Sector with the circulars issued by the IRDAI

Brief of the case: The Company had failed to take cognizance of a circular issued by the IRDAI and to bring out its impact on the accounts by segregation of Shareholders' funds and Policyholders' funds, whereby, the Shareholders' Funds were overstated by **Rs.2370** crore and Policyholders Funds were understated to the same extent. The matter was initially raised in phase-II audit of the Company; however, it was not taken seriously believing that no such circulars had been issued by the IRDAI. This issue was further raised in Phase-III/Final Audit of the company. Again, Officer-In-Charge of Accounts had the same argument that no such circular had been issued by IRDAI.

Ultimately, in the final discussion with the head of the company, along with all the supporting documents, the company had to realise the non-compliance with the above circular.

In another case, Actuarial valuation for provisions was challenged by the writer, due to incorrect calculation/interpretation of IRDAI circulars/regulations leading to creation of a short provision of Rs.107.65 crore in the aforesaid company.

ICS relating to the TSC opinion

ICS-8: A special and exceptional case pertaining to accounting of government grants

Introductory

Under Ujawal DISCOM Assurance Yojana (UDAY), Government of Uttar Pradesh (GoUP) had provided grants of ₹29350.32 crore to the UPPCL/DISCOMs in previous years, in lieu of taking over of the debts of DISCOMs outstanding as on 30 September 2015. As per the accounting policy of the DISCOMs, the above grants had been depicted in "Subsidies towards cost of capital assets" under Capital Reserve in their Annual Financial Statements (AFSs), which were being amortised from year to year, towards equivalent depreciation charged on the related assets created from such grants (earlier loans).

UPERC had approved an additional revenue subsidy of ₹39743 crore for the years 2007-08 to 2019-20 through its various Tariff/True up orders, which was to be released by the GoUP to the DISCOMs. GoUP, vide its orders dated 05 March 2021, acknowledged the aforesaid additional revenue subsidy stating that an amount of ₹ 25081.46 crore shall be deemed to be paid off from the equivalent balance of UDAY grants (₹25081.46), after adjusting from the total UDAY grant of ₹29350.32 crore, the outstanding government dues of ₹4268.86 crore payable to these DISCOMs. Further, the aforesaid orders also provided that the balance revenue subsidy of ₹14661.54 crore (₹39743 crore -₹25081.46 crore) would be provided by the GoUP through budget in the next ten years commencing from 2021-22.

Accounting issue: The accounting treatment done by the DISCOMs with respect to the aforesaid revenue subsidy, major portion (63 percent) of which was to be book adjusted from the UDAY grants, the remaining portion (37 percent) to be received in the next ten years, as per the aforesaid Govt. orders lacked full uniformity and consistency. Further, the above being a special and exceptional case was not properly addressable, as per the accounting policy of the DISCOMs and the provisions of the related Indian Accounting Standards (Ind AS) 20. Accordingly, the above accounting issue needed a uniform accounting treatment based on the best accounting prudence, keeping in view the main objective of the AFSs to reflect faithful information to the users, thereby representing true and fair view.

The Statutory Auditors (except in one DISCOM) could not point out accounting treatment of the aforesaid revenue grants, in their Audit Report on the AFSs of the DISCOMs for the year 2020-21.

During processing of the draft comments on the AFSs of the DISCOMs for the year 2021 at the field office level, the matter was referred to the Technical Support

Cell (TSC) existing in the office, which comprises three members at the level of Sr. Audit Officer (Commercial), including the writer of this article.

The TSC could not arrive at a consensus, and had a bifurcated viewpoint, as indicated below:

(i) One of the viewpoints supported by two members of the TSC indicated that the whole amount of revenue subsidy of ₹39743 crore should have been booked in the Statement of Profit & Loss of the DISCOMs for the year ended 31 March 2021 in terms of their stated accounting policy and provisions of Ind AS 20. In case, this viewpoint is considered, the AFSs of the DISCOMs would depict exceptionally large profitability by ₹39743 crore for the year ended 31 March 2021.

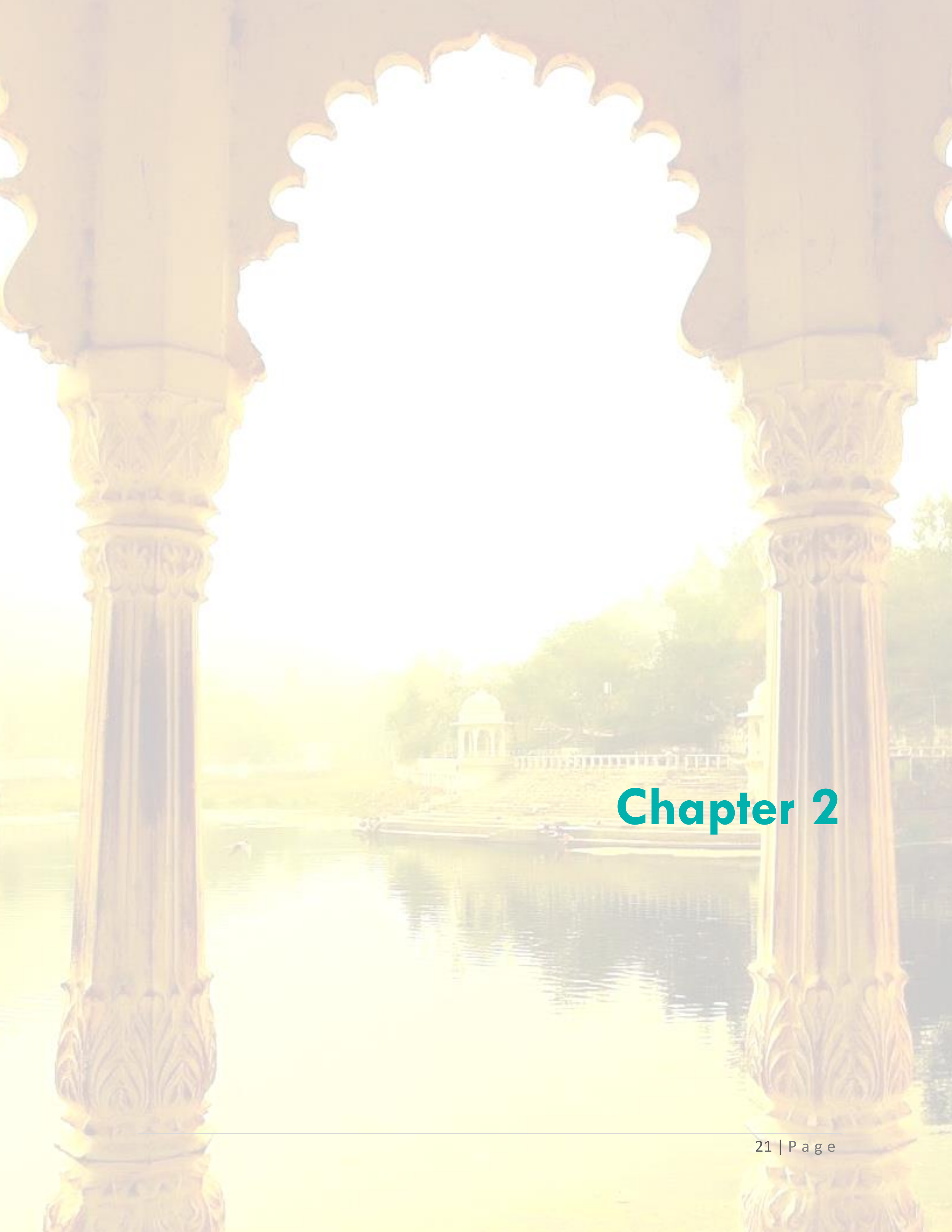
(ii) Another viewpoint supported by one member of the TSC indicated that ₹25081.46 crore should have been depicted in the Retained earnings as on 31 March 2021, thereby reducing the accumulated losses of the DISCOMs to this extent. This viewpoint also indicated that the balance amount of revenue subsidy of ₹14661.54 crore should have been depicted as a Deferred Income in the AFSs 2020-21, from which, one-tenth amount to be shown in the Statement of Profit and Loss for the next ten years. This viewpoint concluded by the above member of TSC was on the basis of main objective of the AFSs to reflect faithful information to the users, thereby representing true and fair view, Ind AS Framework, Ind AS-1, Ind AS 20 and Accounting policy of the DISCOMs read with background of the case and GoUP orders dated 05 March 2021, *in both letter and spirit.*

Solution to the accounting issue

As the TSC was bifurcated in its viewpoints on the accounting treatment for additional revenue subsidy, that could be applied uniformly in the AFSs of the DISCOMs, the matter was referred to the CAG Headquarters for providing guidance on the special and exceptional case pertaining to accounting of government grants as reflected in the Annual Financial Statements of DISCOMs for the year ended 31 Match 2021. The CAG Headquarters considered the second viewpoint which was expressed by the writer of this article as a member to the TSC existing in his office, on accounting treatment of additional revenue subsidy in terms of Govt. orders dated 05 March 2021.

Impact of the opinion

The above opinion led to issue and process of the modified draft comments, including impairment of true and fair view on the AFSs of the DISCOMs, and also of their holding company (UPPCL) for the year 2020-21.



Chapter 2

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(This article explores the applicability of a variant of the technique discussed in the previous issue for auditing use of the minor head 800 in the accounts, for classification check of transactions booked under minor head other than 800. It is recommended that the reader familiarize himself with the earlier article.)

Recap: In the previous article it had been pointed out that audit of classification in accounts had to be done according to the rules laid down in Government Accounting Rules 1990 and the List of major and Minor heads of accounts of the Union and the States. Misclassification in accounts could arise on account of the initial outlays being made under unsuitable heads in the budget or due to wrong bookings in the vouchers. The first category of misclassification can be detected by a study of budget and through a study of transactions and audit enquires with the concerned departments a view could be taken on such cases. This approach had been elaborated in the context of the use of minor head 800 in accounts.

Reviewing budget for audit comments on classification of transactions.

The issue of classification of transactions under the minor head 800 is well known and discussed in audit reports. In this article we review another issue of classification of transactions in accounts that need exploration but is not yet widely discussed.

According to the general instructions[1] given in the list of major and minor heads of account of the union and the states the coding pattern for minor heads has been designed in such a way that in respect of certain minor heads having a common nomenclature under various major / sub major heads, as far as possible, the same three digit code is adopted.

One such minor head is 003 – Training, in terms of the above all expenditure on training should appear under minor head 003 under all major heads where it occurs. To test application of this classification rule / instruction, some detailed demands for grants of four[2] union ministries/ department were studied.

1) **Ministry of Personnel, Public Grievances and Pensions[3]**

Demand no 73 of the Union relates to the Ministry and the Department of Personnel and Training is one of the departments in the Ministry. A review of the grant shows that Ministry uses the minor head 003 to depict outlays on training as given below:

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[1] Paragraph 8 of general instructions on page xxii.

[2] Ministry of Finance, Department of Posts, Ministry of Personnel, Public Grievances and Pensions, Ministry of Home Affairs.

[3] Detailed Demand for Grants 2021-22

2070 00 003 Training 01 Grants in aid to IIPA
02 Lal Bahadur Shastri National Academy of Administration
03 Other training
04 Institute of Secretariat Training and Management
16 Improvement of Infrastructure and upgradation of essential facilities at LBSNAA
18 National Programme for Civil Services & Capacity Building

2) Department of Posts[4]

The department of Posts also uses the minor head 003 for depicting outlay on training. A review of the grant shows that Ministry uses the minor head 003 to depict outlays on training as given below:

3201 02 003 01 Operation training
02 Training Institute learning (This head gives the outlays for training programs for Group A and B officers, in service training and training equipment)

3) Ministry of Home Affairs[5]

Demand no 50 relating to Police under MHA was examined. In this demand the minor head 003 is used to depict outlays for training. A review of the grant shows that Ministry uses the minor head 003 to depict outlays on training as given below:

2055 00 003 (Education and Training) 01 National Police Academy
02 Central Detective training school
04 National Institute of Criminology and forensic sciences
06 North Eastern Police Academy
07 Anti Trafficking cell
08 International Bilateral training programs
09 Central Academy for Police
10 Central Armed Police Forces Institute for Medical Science
11 National Police Academy
12 National Forensic science University
13 Rastriya Raksha University

[4] Detailed demand for grants 2019-20
[5] Detailed demand for grants 2021-22

4) Ministry of Finance[6]

For this Ministry, demand numbers 29, 30, 33,34 and 35 which deal with Department of Economic Affairs, Department of Expenditure, Department of Revenue, Direct Taxes and Indirect Taxes were studied. In the above demands there are variations depiction of outlays on training within departments of the Ministry as well as with the earlier discussed demands.

In the demand of the Department of Economic affairs the outlay for training of Indian Economic Services officers is made under

3075 00 800 (other expenditure) 07 Training of Indian Economic Service Officers

In the demand for grant of the Department of Expenditure outlay on training center of civil accounting department (Institute of Government Accounts and Finance) is made under
2070 00 003 (training) 08 Training Centre in the Civil Accounting Department
(Institute of Government Accounts and Finance)

In the demand for Direct Taxes / Department of Revenue no outlay for training has been reported distinctly even though the Income Tax Department has a National Academy of Direct Taxes and a chain of regional training institutes across the country.

In the demand for Indirect taxes the expenditure on National Academy of Customs, Indirect Taxes and Narcotics (NACIN) is depicted under:

2038 00 001 (Direction and Administration) 03 National Academy of Customs, Indirect Taxes and Narcotics (NACIN)

The foregoing analysis clearly shows that even though a standard minor head has been prescribed for recording expenditure on training in accounts, there are variations in the minor heads used by departments of the same government for providing outlays for training. As accounts follow the budget the expenditure will also appear under the same heads and so these variations need to be examined in audit of classifications for reporting in the annual report on finances.

Just as the head 003 is prescribed for recording expenditure on training, the head 004 is prescribed for recording expenditure on research. The Government funds several Institutes through grants two such institutes are the IIPA and the NIPFP.

According to the website of IIPA, the institute is registered under the Societies Act of 1860 and the major activities of the Institute are training, research, advisory and consultancy services, and information dissemination and exchange. Similarly, the website of NIPFP states that the institute is registered under the Societies Act

[6] Detailed demand for grants 2018-19

of 1860 and the institute undertakes research, policy advocacy and capacity building in areas related to public economics.

Both the institutes receive money as grant from the GoI, despite very similar mandates / activities the outlay on grants to IIPA by DoPT are under minor head training:

2070 00 003 Training 01 Grants in aid to IIPA

01.00.31 Grants in aid General,

01.00.35 Grants for creation of capital assets,

01.00.36 Grants-in-Aid- Salaries

While outlay on grants in aid to NIPFP by Department of Revenue is shown under minor head 800 other expenditure:

2047 00 800 03 Grants in aid to National Institute of public Finance and policy

03.00.31 Grants in aid general,

03.00.36 Grants in aid salaries

While performing a classification check on accounts it would be worthwhile to examine as to why grants to two Institutes performing similar work and receiving grants for same purposes are booked to two different heads 003 training in one case and 800 other expenditure in the other. Another issue that can be examined is if 003 training was not considered appropriate for grants to NIPFP, why the minor head 004 Research was not considered in place of 800 other expenditure?

As discussed in the earlier article the above issue of classification of transactions can be taken up through audit enquires with the concerned auditees and appropriate view taken on receipt of responses.

In brief the auditor should study the budget in the light of the rules governing classifications in accounts and identify cases for follow-up using the approach outlined in the above and earlier article.

Canons of Financial Propriety

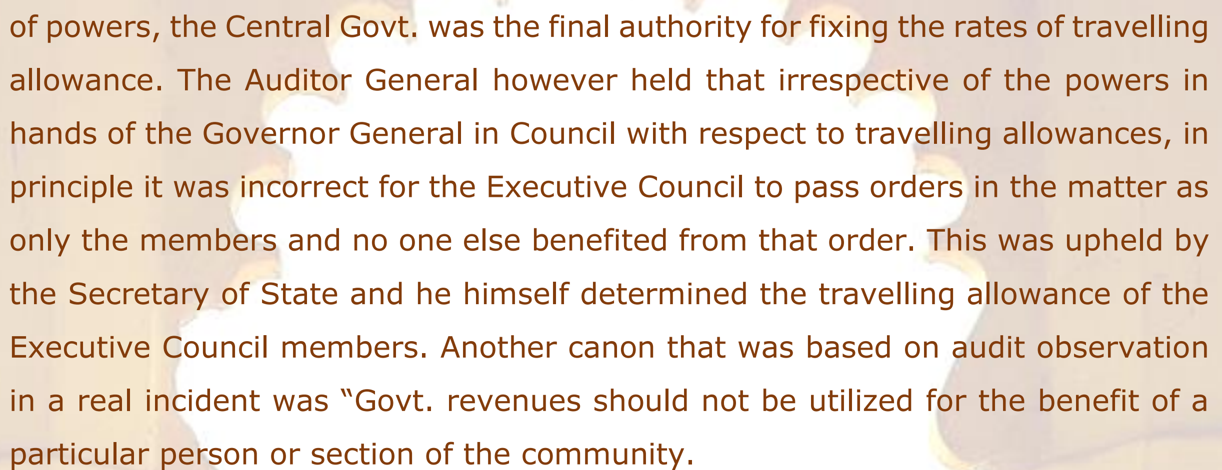
As members of the audit department auditors are expected to be familiar with financial rules and regulations. Rule 21 of the General Financial Rules 2017 lays down some standards often referred to as the canons of financial propriety. While most of us are aware of these canons, what is not so commonly known is that these canons had developed largely as a result of experience gained in the office of the Auditor General while arriving at several audit decisions in the years prior to the passage of Govt. of India Act 1919. These canons were incorporated in Rule 10 of the Auditor General's rules framed on 4th January 1921.

These canons were to be followed irrespective of any check audit may apply. The Auditor General was made responsible that audit was conducted with reference to the canons. The canons clearly indicate that audit was not to be confined to scrutiny based on regularity and fidelity alone but were also to look into propriety of transactions.

The first canon, the extravagance canon stated that every public officer should exercise the same vigilance in respect of expenditure incurred from Govt. revenues as a person would exercise in respect of his own money.

This canon which established the right of audit to intervene in essentially broad principles of public policy were not contravened, or essentially wasteful expenditure made. Wasteful but otherwise valid transaction could have been based on an audit observation made in 1887 in England when the War Office cancelled a contract for ribbon at 14 shillings with one firm and gave out another contract to another firm for a similar ribbon at 20 shillings. In this case, the audit observation was upheld by the Public Accounts Committee. This also illustrates a good example of a case where audit observations can be raised on grounds of extravagance.

Another canon was that: No authority should exercise its powers of sanctioning expenditure to pass an order which will be directly or indirectly to its advantage. While this appears to be common sense, it is actually based on a specific instance. The Government of India made some rules for increasing the travelling allowance due to members of the Viceroy's executive council. In terms of existing delegation



of powers, the Central Govt. was the final authority for fixing the rates of travelling allowance. The Auditor General however held that irrespective of the powers in hands of the Governor General in Council with respect to travelling allowances, in principle it was incorrect for the Executive Council to pass orders in the matter as only the members and no one else benefited from that order. This was upheld by the Secretary of State and he himself determined the travelling allowance of the Executive Council members. Another canon that was based on audit observation in a real incident was "Govt. revenues should not be utilized for the benefit of a particular person or section of the community.

This canon arose from a case in 1912. During the Delhi Darbar, a polo ground was prepared for exhibition to the King Emperor. After the durbar it was maintained at State expense. The Audit Officer at Delhi observed that Govt. funds should not be used to maintain the polo ground because a very limited number of persons playing polo benefited by it and they should rightly bear it. This observation was upheld by the Government in the U.K. and formed the basis of this canon. It has a caveat that such expenditure could be done where it was in pursuit of a recognized policy or custom, this is because the Govt. had traditionally been giving endowments to religion/charitable bodies and institutions.

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