

# **CHAPTER-1**

## ***INTRODUCTORY***

### **1.01 General**

The provisions in this manual are intended to assist and guide the staff engaged in the conduct of audit of all bodies and authorities either of non-commercial nature or of commercial nature in certain respects, which are required to perform certain specified services of public utility or to execute certain programmes and policies of the Government, essentially out of financial assistance from the Government (Central as well as State). Such bodies and authorities include amongst others, District Rural Development Agencies, State Universities, Colleges, Development Authorities, Uttarakhand Peyjal Sansadhan Evam Nirman Nigam, and Jal Sansthan, etc.

These provisions do not apply to Government Companies and other commercial corporations.

### **1.02 Authority for the audit of autonomous bodies**

The basic authority for the audit of the autonomous bodies is derived from Article 149 of the Constitution of India, which, inter-alia, provides that the Comptroller and Auditor General shall perform such duties and exercise such powers in relation to the accounts of any authority or body, as may be prescribed by, or under any law made by Parliament or the State Legislatures. The audit of the accounts of these bodies is conducted under the provisions of Sections 14, 15, 19 and 20 of the Comptroller and Auditor General's (Duties, Powers and Conditions of Service) Act, 1971 and the Act as amended in 1984 to ensure that these bodies are properly held accountable for the public funds placed at their disposal and they do achieve the objects with which they are set up or programmes entrusted to them. The provisions of Section 18 of the Act, empowering the Comptroller and Auditor General to inspect any office of accounts; to call for accounts records and any other information relevant for the conduct of audit, are also applicable to the audit of the autonomous bodies conducted under the above mentioned section of the Act.

### **1.03 Meaning of authority, body and corporation**

The words “authority” and “body” used in Article 149 of Constitution, have not been defined either in the Constitution or in the CAG’s (DPC) Act 1971. “Authority” has been interpreted by the Attorney General of India to mean a person or body exercising power or command vested in it by virtue of provisions in the Constitution or Acts passed by the Parliament or the State Legislatures. “Body” has been interpreted by Attorney General to mean an aggregate of persons, whether incorporated or unincorporated. The terms “Body” or “Authority” used in the Act have a wide connotation and include a “Company” or “Corporation”. “Corporation” (used in Section 19 of the Audit Act) means any body corporate established by or under an Act of Legislature, having perpetual succession with a common seal with power to acquire or dispose of property, to contract obligations and to sue or be sued in its corporate name.

The audit of Government Companies and other corporations is conducted by the Economic Sector of this office. Also refer to Para 2.04.02 of Chapter 2 of this manual.

### **1.04 Scope of Audit**

Normally, the audit examines the books of accounts of autonomous bodies to ensure that the final accounts as drawn up, exhibit a true and fair view of the working and the state of affairs of the body or authority. Most of the bodies have little income of their own and Boards, Development Authorities etc. which earn income by rendering services or sale of products & properties, also depend on Government to a considerable extent for financial assistance in the shape of grants, loans etc. In all such cases, the audit has to go beyond certification of annual accounts to probe into aspects relating to efficiency, performance, propriety, etc., with regard to the utilization of the resources made available to them by Government. Here the audit of transactions of Government will also have to be carried out in relation to release of such assistance and watch is exercised by Government over utilization, return of loans, etc.

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 Department / Sector in the State Government or

the Central Government being the top layer would be defined as the Apex Auditable Entity. Since policy formulation and oversight flow from the Departments/Sectors (Apex Auditable Entities) and responsibility for implementation of schemes/programs vests with the lower formations of the Government (Directorates /Commissionerates/zones, divisions, circles, ranges etc.), a significant portion of the risk is embedded in these layers, while the lowest layer is typically the implementing arm and accountability for its performance invariably rests with the higher organisational hierarchies. The top down approach for identification of audit units mentioned in these guidelines therefore envisages that audit units are identified beginning with higher organisational hierarchies of the Apex Auditable Entity and fanning out to operational units at the field level.

#### **1.05 Code of Conduct**

The audit of the autonomous bodies by the Indian Audit and Accounts Department is conducted under powers vested in the Comptroller and Auditor General of India, as delegated by him to the officers of his department, and it is important to note that it is not permissible to make independent enquires of the tax payer or the general public, unless such a course is expressly authorised by statutory provisions of executive orders.

#### **1.06 Matters dealt with to be kept confidential**

The inspecting staff should carefully note that matters, with which they have to deal during the course of audit of autonomous bodies, are kept confidential. The results of audit inspection of the accounts are also not to be made public before the Audit Report incorporating the results, is placed before the State Legislature.

#### **1.07 Disclaimer-Regarding inclusion of disclaimer in part-1 of Inspection Reports**

All Inspection Reports forwarded by the field parties to the Headquarters shall bear with the following disclaimer statement on the top of Part-I of the Audit Inspection Report as per para 2.3 of order of the C & A.G. of India circular no. 629 LC/III-2005 dated 7<sup>th</sup> October 2005 on the subject, Right to Information Act, 2005- Disclosure of the Information regarding- “The Inspection Report has been prepared on the basis of information furnished and made available by.....(Name of auditee entity).

The Office of Accountant General (Audit) Uttarakhand, Dehradun disclaims any responsibility for any misinformation and/or non- information on the part of auditee”

The Head of the auditee unit as also the Inspecting Officer/ party incharge of the audit party should invariably sign the disclaimer.

## **CHAPTER-2**

### ***PROVISIONS AND SCOPE OF SECTIONS 14, 15, 19 AND 20 OF AUDIT ACT.***

#### **2.01 Purpose of audit**

The purpose of audit of autonomous bodies is to watch over utilization of assistance rendered by Government and to certify the annual accounts. The utilisation of Government assistance can be undertaken under all the four Sections, but the job of certification of annual accounts is undertaken only under the provisions of Sections 19 and 20. The scope and extent of these Sections are considered in the succeeding paragraphs of this Chapter.

#### **2.02 Section 14 of the Audit Act**

(1) Under sub Section (1) of Section 14 of the Act, it is obligatory for Comptroller and Auditor General of India to audit all receipt and expenditure of any body or authority and to report there on, if the body or authority has been substantially financed by grants and/or loans from the Consolidated Fund of India, or any State or any Union Territory, having a Legislative Assembly. A body or authority is deemed to be so financed if the amount of grant or/and loan to it in a financial year is not less than Rupees 25 lakh and is also not less than 75 percent of its total expenditure in that year. Audit under this Section is subject to the provisions of any law applicable to the body or authority, and will co-exist with and complement the audit arrangements, if any, that may be specified in such law.

(2) Where the amount of grants and/or loans from the Consolidated Fund of India or of a State or of a Union Territory having a Legislative Assembly as the case may be, to a body or authority in a financial year is less than 75 percent of its total expenditure during that year, sub- Section (2) of Section 14 empowers the Comptroller and Auditor General of India to audit all its receipts and expenditure with the previous approval of President or Governor of the State or the Administrator of Union Territory as the case may be, if the amount of such grants and /or loans is not less than rupees one crore. However, if the amount of grants and / or loans is not less than Rupees one crore and also forms not less

than 75 percent of the total expenditure of the institution, it will attract audit by the Comptroller and Auditor General of India under sub- Section (1). Only where the later part of this condition is not satisfied, audit under sub-Section (2) will arise.

**(3)** Once an institution comes under audit of Comptroller and Auditor General by virtue of the provisions of sub- Section (1) or (2) of Section 14, such audit will, however, under sub Section (3) *ibid*, continue for two subsequent years even if the conditions prescribed in sub Section (1) and (2) are not fulfilled in these years.

**Note:** - The provisions of sub-Section (2) and (3) of Section 14 referred to above are applicable only with effect from the financial year 1983-84

**2.02.01** This Section deals with the audit of the accounts of autonomous bodies, which are considered to be substantially financed from the Consolidated Fund in a year. Thus, a autonomous body, which is in receipt of grant or loan or both from the Consolidated Fund of India or of the States of not less than Rs. 25 lakh, such grant or loan or both being not less than 75 percent of the total expenditure in a year, is considered to be substantially financed.

**2.02.02** As mentioned above, the grant or loan must be paid from the Consolidated Fund. If any grant or loan is financed from funds outside the Consolidated Funds of the Government, such grants or loans cannot be taken into account for the purposes of Section 14 unless the transaction is routed through the Consolidated Fund. Grants or loans, received by a autonomous body through another autonomous body, will have to be excluded from consideration for applicability of Section 14 unless it can be clearly established that the autonomous body releasing the grant or loan was acting merely as an agent of Government for remitting the money provided by Government from it's Consolidated Fund.

**2.02.03** Transfer of revenues of Government to the autonomous bodies is in some cases, initially accounted for in account either as a reduction of receipts or as a specific item of expenditure and in other cases, the beneficiaries directly collect and appropriate the revenues. Assignment cannot be treated as payment of grants by the Government to the autonomous bodies. On the other hand, assigned revenues paid by debit to the

Consolidated Fund stand recognized by the Government and payments out of such revenues are discretionary to be specifically voted by the Legislatures. Accordingly, such payments can be treated as grants for the purpose of Section 14.

**2.02.04** The quantum of grant or loan in a year has to be computed with reference to the following principles:

“If the amount of the grant or loan or both (in any financial year) together with the unutilized grant or loan both, carried over from the preceding financial year from either the Consolidated Fund of India or of any State or of any Union Territory having a Legislative Assembly are, in a financial year, collectively not less than Rs. 25 Lakh in that year, the autonomous body can be covered under audit under Section 14 provided the other provision regarding percentage expenditure is also fulfilled.

It needs to be noted in this regard that only “unutilized” loans should be taken into account and not the entire outstanding amount.

With the amendment of the Act in 1984; sub-Section (2) of Section 14 empowers the Comptroller and Auditor General of India with the prior approval of President/ Governor/ Administrator of a Union Territory having Legislative Assembly, to audit all receipt and expenditure of any body or authority where the grants or loans or both to body or authority from the Consolidated Fund is not less than rupees one crore in a financial year.

**2.02.05** Sometimes, the financial year of an autonomous body is not the same as that of Government e.g., the financial year of co-operative societies runs from 1<sup>st</sup> July to 30<sup>th</sup> June. In such cases the applicability of Section 14 will have to be determined with reference to the normal accounting year of the autonomous body and not of the Government.

**2.02.06** The term “total expenditure” is interpreted to mean both revenue and capital expenditure. In respect of institution running business, the expenditure incurred on purchase of raw materials, finished goods, loans and grants disbursed etc., should be accounted for as expenditure. Payments of purely deposit nature, e.g., deposit for works done, income tax recoveries, advances to staff, investment of cash balances, transfer of balance between main office and branch office, provident fund transactions of employees

etc., are not to be treated as expenditure and such transactions are to be omitted for purposes of compilation of total expenditure.

**2.02.07** Audit under Section 14 does not preclude certification of accounts. But, it is not obligatory on the part of the Comptroller and Auditor General of India to certify the annual accounts under Section 14. The main objective of audit under Section 14 is to include in the reports, the findings of audit of the substantially financed bodies or authorities. Hence, the Comptroller and Auditor General of India cannot be compelled to certify the annual accounts for placing it before the management of the autonomous bodies.

### **2.03 Section 15 of the Audit Act**

Section 15 provides as follows: -

(1) where any grant or loan is given for any specific purpose from the Consolidated Fund of India or of any State or of any Union Territory having a Legislative Assembly to any authority or body, not being a foreign State or international organisation, the Comptroller and Auditor General shall scrutinise the procedures by which the sanctioning authority satisfies itself as to the fulfillment of the conditions subject to which such grants or loans were given and shall for this purpose have right of access, after giving reasonable previous notice, to the books and accounts of that authority or body.

Provided that the President, the Governor of State or the Administrator of Union Territory having a Legislative Assembly, as the case may be, may, where he is of opinion that it is necessary to do so in the public interest, by order, relieve the Comptroller and Auditor General after consultation with him, from making any such scrutiny in respect of any body or authority receiving such grant or loan.

(2) Except where he is authorized to do so by the President, the Governor of a State or the Administrator of a Union Territory having a legislative Assembly, as the case may be, the Comptroller and Auditor General shall not have, while exercising the powers conferred on him by sub-Section (I) right of access to the books and accounts of any corporation to which any grant or loan, as is referred to in sub- Section (i) is given, if the law by or under which such corporation has been established provides for the audit of the

accounts of such corporation by an agency other than the Comptroller and Auditor General.

Provided that no such authorisation shall be made except after consultation with the Comptroller and Auditor General and except after giving the concerned corporation a reasonable opportunity of making representation with regard to the proposal to give to the Comptroller and Auditor General the right of access to its' books and accounts.

### **2.03.01 Section 15 has two parts**

The first part imposes a statutory responsibility on the Comptroller and Auditor General of India to scrutinize the procedure by which the authority sanctioning a grant or loan for specific purpose to an autonomous body from the Consolidated Fund, satisfies itself as to the fulfillment of the conditions subject to which such grants or loans were given.

The second part gives the Comptroller and Auditor General of India the right of access to the books and accounts of the autonomous body subject to the following restrictions:-

- (1) The autonomous body is not a foreign State or an international organisation;
- (2) The President/ Governor/ Administrator concerned, can, in public interest, relieve the Comptroller & Auditor General after consultation with him, from making any such scrutiny in respect of any autonomous body; and
- (3) Except with the authority of the President/ Governor/Administrator concerned, the right of access to the books and accounts of any corporation is not available, if the law by or under which the corporation is established, provides for audit by someone other than the Comptroller and Auditor General.

**2.03.02** While it is obligatory for the Comptroller and Auditor General to examine the records of the sanctioning authority relating to the procedure adopted for ascertaining utilization of grants or loans for specific purpose, it is not obligatory to scrutinize the books and accounts of all autonomous bodies, where records are open to inspection under this Section. Here, the Comptroller and Auditor General has the discretion to limit the scrutiny to the extent he decides.

**2.03.03** The scrutiny relates to grants or loans given for specific purposes only. Grants given for maintenance, purchase/ procurement of specific items like building equipment etc., grants given to cover deficit, subsidies for purchase of tools, plants etc., are all to be treated as specific purpose of grants. In doubtful cases, the relevant files leading to issue of sanction can be consulted.

#### **2.04 Sections 19 and 20 of the Audit Act**

Sections 19 and 20 of Audit Act provide as follows:

##### **Section 19**

(1) The duties and powers of the Comptroller and Auditor General in relation to the audit of the accounts of Government Companies shall be performed and exercised by him in accordance with the provisions of the Companies Act, 1956 (I of 1956).

(2) The duties and power of the Comptroller and Auditor General in relation to the audit of the accounts of corporations (not being companies) established by or under law made by Parliament shall be performed and exercised by him in accordance with the provisions of the respective legislations.

(3) The Governor of a State or the Administrator of a Union Territory having a Legislative Assembly may, where he is of opinion that it is necessary in the public interest to do so request the Comptroller and Auditor General to audit the accounts of a corporation established by law made by Legislature of the State or of the Union Territory, as the case may be, and where such request has been made, the Comptroller and Auditor General shall audit the accounts of such corporation and shall have, for the purposes of such audit, right of access to the books and accounts of such corporation.

Provided that no such request shall be made except after consultation with the Comptroller and Auditor General and except after giving reasonable opportunity to the corporation to make representation with regard to the proposal for such audit.

## **Section 19 A**

(1) The reports of the Comptroller and Auditor General, in relation to the accounts of a Government company or a corporation referred to in Section 19, shall be submitted to the Government or Governments concerned.

(2) The Central Government shall cause every report received by it under sub-Section (1) to be laid, as soon as may be, after it is received, before each House of Parliament.

(3) The State Government shall cause every report received by it under sub Section (1) to be laid, as soon as may be, after it is received, before the Legislature of the State.

**Explanation:** - For the purpose of this Section “Government” or “State Government” in relation to a Union Territory having a Legislative Assembly, means the Administrator of the Union Territory.

## **Audit of Accounts of Certain Authorities or Bodies Under Section 20**

(1) Save as otherwise provided in Section 19, where the audit of the accounts of any body or authority has not been entrusted to the Comptroller and Auditor General by or under any law made by Parliament, he shall, if requested so to do by the President or the Governor of State or the Administrator of a Union Territory having a legislative Assembly, as the case may be, undertake the audit of the accounts of such body or authority on such terms and conditions as may be agreed upon between him and the concerned Government and shall have, for the purposes of such audit, right of access to the books and accounts of that body or authority;

Provided that no such request shall be made except after consultation with the Comptroller and Auditor General.

(2) The Comptroller and Auditor General may propose to the President or the Governor of a State or the Administrator of a Union Territory having a Legislative Assembly, as the case may be, that he may be authorised to undertake the audit of the accounts of any body or authority, the audit of the accounts of which has not been entrusted to him by law, if he is of opinion that such audit is necessary because substantial amount has been invested in, or advanced to, such body or authority by the

Central or State Government or by the Government of a Union Territory having a Legislative Assembly, and on such request being made, the President or the Governor or the Administrator, as the case may be, may empower the Comptroller and Auditor General to undertake the Audit of the accounts of such body or authority.

(3) The audit referred to in sub-Section (1) or sub-Section (2) shall not be entrusted to the Comptroller and Auditor General except where the President or the Governor of a State or the Administrator of a Union Territory having a Legislative Assembly, as the case may be, is satisfied that it is expedient so to do in the public interest and except after giving a reasonable opportunity to the concerned body or authority to make representations with regard to the proposal for such Audit.

#### **2.04.01 Audit of Government Companies:**

Sub-Section (1) of Section 19 deals with duties of Comptroller & Auditor General in relation to the audit of the accounts of Government Companies in accordance with the provisions of the Companies Act, 1956/ Companies Act, 2013.

#### **2.04.02 Audit of corporations established by or under Act of Parliament:**

Section 19(2) deals with the audit of such corporations, where the Audit Act 1971 provides that the audit of these corporations shall be performed and exercised by Comptroller & Auditor General in accordance with the provisions of the respective legislations. The word “Legislation” used in this Section refers not only to the parent acts relating to the corporations but also to rules and regulations framed by competent authorities by virtue of powers vested in them under the relevant Acts of Parliament.

#### **2.04.03 Audit of state corporations and other bodies and authorities:**

Section 19(3) of the Audit Act deals with the entrustment of audit in public interest, of the accounts of corporations established by Acts of State and Union Territory Legislature and Section 20(i) with all other autonomous bodies or authorities. The provisions of both the Sections in entrustment of audit are similar except that Section 20 (1) provides also for settlement of terms and conditions. Section 19 (3) makes no such provisions.

### **Essential requirements of Sections 19 (3) and 20 (1)**

The first requirement is that audit can be entrusted to Comptroller and Auditor General only in public interest. The second requirement is that no audit can be entrusted to the Comptroller and Auditor General except after giving reasonable opportunity to the autonomous body to make representations with regard to the proposal for such audit.

The third requirement is that the request of the Government is made only after consultation with the Comptroller and Auditor General. Government may inform its intention to the concerned Audit Officer. But it is necessary, in every case that prior and specific clearance from the office of the Comptroller and Auditor General is obtained by the Audit Officer before a decision to accept or reject a proposal is conveyed to Government.

The fourth requirement of Section 20 is that audit entrusted to the Comptroller and Auditor General on such terms and conditions as may be agreed upon between the Government and the Comptroller and Auditor General. The standard terms and conditions are given in **Annexure-1**. Any violation of terms and conditions noticed during the period of currency of arrangement of audit should be promptly brought to the notice of Government and the Comptroller and Auditor General, and audit proceeded with only after receipt of specific clearance from the Office of the Comptroller and Auditor General.

**2.04.04** After fulfillment of the requirements, it is necessary that a formal request is sent by the Government in the name of President/ Governor/ Administrator for entrusting the Audit to the Comptroller and Auditor General. A specimen of the letter of request, in the form adopted by the Government of India, is given in **Annexure- 2** for guidance.

#### **2.04.05 Audit of autonomous bodies at the request of the Comptroller and Auditor General**

If the Comptroller and Auditor General feels that a substantial amount has been invested in or advanced to such autonomous bodies, the audit of the accounts of which has not been entrusted to him, he is empowered, under Section 20 (2) of the Audit Act to propose to the President/ Governor/ Administrator for conduct of audit of the accounts of these bodies. The Government can entrust the audit of such bodies to the Comptroller and

Auditor General, if they are satisfied that it is expedient to do so in public interest and after giving reasonable opportunity to the autonomous body to make representation with regard to the proposal for such audit.

## **CHAPTER-3**

### ***AUDIT UNDER SECTIONS 14, 15, 19 AND 20 OF CAG'S (DPC) ACT, 1971***

#### **3.01. Audit under Section 14**

**3.01.01** The first step is to identify every year the autonomous bodies that attract audit under Section 14. For the purpose, a list of autonomous bodies in receipt of grants and loans from the Consolidated Fund has to be compiled. Since the unutilized grants or loans at the commencement of a particular year are to be taken as grants or loans for the purposes of applicability of Section 14, a procedure should be drawn up in consultation with Government to provide for supply of information with regard to unutilized grant and/ or loan with the autonomous bodies at the commencement of each financial year.

**3.01.02** The information so collected, must be posted in the register (**Annexure- 3**) and therefrom a list of bodies that are in receipt of grant or loan or both of not less than Rs 25 lakh should be drawn up. The applicability of Section 14 may be examined with due regard to the instructions given in para 2.02.01 and 2.02.04 of Chapter 2.

**3.01.03** Having ascertained the units to be audited under Section 14, the concerned Department of the State Government should be addressed to notify the concerned autonomous bodies that the audit of their accounts would be taken up by the Principal Accountant General/ Accountant General (Audit), Uttarakhand, under Section 14 and that, for this purpose, the books of accounts and other records be made available and necessary facilities provided for.

**3.01.04** Since audit under Section 14 is subject to provisions of any law for the time being in force applicable to the body or authority, it is always preferable that audit under Section 14 is taken up only after annual accounts are audited and certified by the auditors appointed for the purpose by the autonomous body/Government. Where, however, no regular auditor has been appointed and annual audit has been in arrears for long period, there is no objection for audit under Section 14 being taken up but in such cases, audit should be so conducted so as to see that in case the C&AG is required to certify the accounts also, the accounts can be duly certified.

**3.01.05** In respect of institutions in other States to which grants and loans are paid by a State Government, the audit officer will draw a list for each of the States involved from the information collected by him and furnish the same to the audit officers of such States annually, who will take note of them in their records for certification and audit under Section 14.

**3.02 Audit under Section 15**

**3.02.01** As discussed in para 2.03 of Chapter 2, audit under Section 15 has two parts. The first part relates to the statutory responsibility of the Comptroller & Auditor General to scrutinize the procedures by which the sanctioning authorities satisfy themselves about the utilisation of grants and loans given for specific purpose. For performance of this responsibility, the office has to maintain a record of authorities (in the format mentioned in **Annexure-4**) who have been authorised to sanction/ disburse grants and loans and to obtain from them annually, the particulars of grants and loans released by them. To enable arrangement of audit, the information gathered from various sources should be detailed in a register, wherein information on grants sanctioned and paid by each sanctioning authority should be detailed.

**3.02.02** From the record of sanctioning authorities, a list of sanctioning authorities to be audited in each year should be prepared (form given in **Annexure-5**). In accordance with the periodicity of audit as determined locally, suitable programmes for local audit of the sanctioning authorities should be drawn up, timely intimation given and audit undertaken.

**3.02.03** For the second stage of audit under Section 15, the institutions to be audited can be either selected in advance with reference to available data at the Headquarters or the selection can be left to the discretion of Inspecting/ Supervising officer of the party with due regard to specific guidelines available for the purpose. In either case, it is preferable that the audit of the institutions is both preceded and followed by scrutiny of records of the sanctioning authority. Further, before audit is taken up, the sanctioning authority should be advised to give due intimation of the audit programme to the institution with instructions to keep relevant documents ready for audit and to render necessary facilities. It is also advisable to furnish an advance questionnaire on points that

need clarification or where data is to be collected, both to the sanctioning authority and the institutions to be audited.

### **3.03 Audits under Sections 19(2), 19(3) and 20(1):**

**3.03.01** Audit under Sections 19(2), 19(3) and 20(1) is taken essentially for purposes of certification of annual accounts but there is no objection to take up such audit for certain specified purposes as well. Under Section 19(2), the duty is cast on the Comptroller and Auditor General by specific provision in the Parliamentary enactments, while under Section 19(3) and 20(1), audit can be entrusted only after prior consultation with the Comptroller and Auditor General.

**3.03.02** The proposals for taking up audit under the above mentioned Sections are received in the Offices of the respective State Principal Accountants General/ Accountants General. The proposals for taking up audit may be examined on the following lines:

- (i) Whether the Government has satisfied itself that it is necessary for the audit to be entrusted in public interest to the Comptroller and Auditor General;
- (ii) Whether the audit office is adequately equipped to take up the work, with regard to its staff position, availability of trained personnel, etc;
- (iii) Whether the duties cast on the audit according to acts, rules and regulations are capable of being discharged;
- (iv) Whether audit will be conducted by the Indian Audit and Accounts Department alone or whether there will be a second auditor; in the latter case, what are the relative duties of the two auditors and whether such a situation is acceptable;
- (v) Whether concerned Legislature has shown interest in its activities by providing for submission of annual returns and reports of auditors before it;
- (vi) Period from which audit is to be taken up;
- (vii) Whether the standard terms and conditions for taking up audit are capable of being enforced;

- (viii) Whether the concerned autonomous body had been consulted and if so, what were its views; and
- (ix) Whether the autonomous body has branch units. If so, what is the arrangement for drawl of funds, collection of income, accounting of transactions, and arrangements for audit of branch units.

**3.03.03** Having examined the proposal on the above lines, the case must be referred to the Office of the Comptroller & Auditor General with full details and the views of the Principal Accountant General/ Accountant General on the request whether it be for acceptance or rejection of the proposal. At the time of forwarding acceptance of proposals, it is necessary to convey to the Government the terms and conditions under which audit can be under taken. The decision can be conveyed to the Government only on receipt of the views of the Office of the Comptroller & Auditor General.

**3.03.04** The audit arrangement is complete only on receipt of a formal request in the name of the President/Governor/Administrator addressed to the Comptroller and Auditor General.

**3.03.05** On receipt of the request, arrangements should be made to contact the autonomous body and to bring about a working arrangement for conduct of audit and issue of audit certificate with audit report there on. Inter-alia, the arrangement should give due attention to the following points:

- (i) the date by which accounts will be made available to audit;
- (ii) the time required and a tentative period during which audit will be conducted;
- (iii) adequate internal arrangement with in the organisation for ensuring availability of records etc;
- (iv) period by which draft audit report will be issued and replies furnished by the organization; and
- (v) period within which the finalised audit report with audit certificate will be issued.

**3.03.06** The audited accounts of the autonomous bodies assisted by Government should be placed before Parliament/Legislature with in a period of 9 months from the date of closure of annual accounts. A workable time schedules can be as under:

a. Submission of accounts by the organisation	30 <sup>th</sup> June of succeeding financial year.
b. Completion of audit	31 <sup>st</sup> August
c. Draft audit report, with a copy to the C&AG, to be issued to the organizations by the Principal Accountant General/ Accountant General	25 <sup>th</sup> September
d. Receipt of replies to audit comments from the organisation by the Principal Accountant General/ Accountant General.	15 <sup>th</sup> October
e. Submission to the Office of C&AG wherever necessary	30 <sup>th</sup> September
f. Finalized Audit Report to be sent to Government for placing before the Legislature.	31 <sup>st</sup> October
g. Due date for placing the Audit Report on the table of the Legislature	31 <sup>st</sup> December or in the earlier session after that date

#### **3.04 Control over the audit**

As audit under these Sections involves discharge of prescribed statutory responsibility, it is essential that proper control is exercised in ensuring that audit is conducted according to the schedule laid down in para 3.03.06 of this chapter. To avoid any omission in conducting audit, the local control registers viz., Cycle Register, Skeleton Register, Separate Audit Report, Progress Register should be kept up to date and scrutinised by the Group Officer periodically. The due dates for such scrutiny may be determined locally and should be got noted in the Calendar of Returns for watching compliance.

## **CHAPTER-4**

### ***FORMATION AND FUNCTIONS OF AUTONOMOUS BODIES WING***

#### **4.01 Introductory**

The Social and Economic Sectors of this office conduct audit of the accounts of various bodies or authorities, coming under the jurisdiction of the State, under the provisions of Sections 14, 15, 19 and 20 of the Audit Act.

#### **4.02 Functions of the Social and Economic Sector**

The functions of the Social and Economic Sectors regarding audit of Autonomous Bodies are briefly described as under:

- (i) Audit of receipts and expenditure of bodies or authorities substantially financed from Union or State Revenues (Section 14)
- (ii) Procedural audit of the records of sanctioning authorities sanctioning grants and loans for specific purpose to bodies or authorities, (Section 15).
- (iii) Audit of the accounts of Corporations (not being Companies) established by or under law made by Parliament/State Legislature (Section 19(2)).
- (iv) Audit of the accounts of a corporation established by law made by the Legislature of the State where a request is made by Governor of the State (Section 19(3)).
- (v) Audit of the accounts of any body or authority entrusted to Comptroller and Auditor General of India by or under any law made by Parliament, on the request of President (in case of Central Units) and Governor (in case of State Units) (Section 20 (1) ).
- (vi) Audit of the accounts of such bodies or authorities, whose branch units exist in the State though their main offices are outside the State (Section 19 and 20).

- (vii) Audit of such bodies or authorities substantially financed, where Principal Accountant General/ Accountant General feels that the audit under Section 14 is not serving the purpose, he may propose detailed annual audit under Section 20(2).

#### **4.03 Organization of the Sector**

##### **Staffing pattern**

##### **(a) Social Sector**

The proposed Sanctioned Strength vis-à-vis PIP as per Audit Plan-2014-15 of the Social Sector approved by AG (Audit) Uttarakhand on 02-06-2014 is detailed below-

<b>Post</b>	<b>SS</b>	<b>PIP</b>	<b>Hqrs.</b>	<b>Field</b>
Sr.AO/AO	14	14	02	11+1
AAO	46	26	03	23
Sr.Ar/AR	82	19	08	11

##### **(b) Economic Sector II**

The proposed Sanctioned Strength vis-à-vis PIP as per Audit Plan-2014-15 of the Economic Sector II approved by AG (Audit) Uttarakhand on 02-06-2014 is detailed below-

<b>Post</b>	<b>SS</b>	<b>PIP</b>	<b>Hqrs.</b>	<b>Field</b>
Sr.AO/AO	08	08+01	01	07+01
AAO	28	21	02	19
Sr.Ar/AR	26	13	03	10

This is the total Sanctioned Strength vis-à-vis PIP of Social Sector and Economic Sector II of this Office from which staff for the audit of respective ABs is derived.

##### **Duties of Deputy Accountant General Social Sector/Economic Sector II**

Sr.Deputy Accountant General/ Deputy Accountant General, Social Sector/Economic Sector II is incharge of the sector in respect of all matters viz., postings and transfers of officers and staff, preparation of Cycle Register, Skeleton of programme, Staff cases, and other administrative matters pertaining to the respective Sector besides supervision of editing work, compliance and settlement of paras of Audit Inspection Reports and Separate Audit Reports of Uttarakhand Jal Sansthan and processing of draft paras for

the State Civil Audit Report. The Group Officer is required to carry out field inspection for minimum of 07 days in a month as per Headquarters Circular No-4/ Audit (AP)/ No. 103-Audit(AP)/236-95 dated 25.06.2007.

## **Functions of Headquarters Section**

### **I. Co-ordinating Section**

Social Sector/Economic Sector II is the Co-ordinating section at Headquarters. This section is headed by a Sr. Audit Officer/ Audit Officer who assists the Sr.DAG/DAG/Social/Economic Sector in disposal of work at Headquarters and establishes coordination between different Headquarters Sections and field parties. The functions of co-ordinating section may broadly be grouped as under:

#### **I. Technical**

#### **II. Administrative**

#### **(I) Technical function**

- (i) Preparation of annual skeleton programme of local audit to be conducted during next year.
- (ii) Preparation of quarterly programme for field parties.
- (iii) Preparation of tour programme of all parties and Inspecting officers.
- (iv) Issue of intimations to units concerned. (format at Annexure 11)
- (v) Disposal of all references including complaints, received from Headquarters, other Accountants General and other entities.
- (vi) Formulation of staff requirements, etc.
- (vii) Disposal of all general questions relating to local audit of the units coming under the jurisdiction of Principal Accountant General/ Accountant General (Audit).
- (viii) Collection of information and returns required in connection with audit of units entrusted under Sections 19 (3) and 20 (1) of the CAG's(DPC) Act and also making review of such bodies in September each year and a list of bodies/institutions, the period of entrustment of which will be over after audit of

the accounts of that year, may be sent to Government by 15<sup>th</sup> September each year to enable them to consider re-entrustment of audit well in time to avoid delay in completion of audit, certification of accounts and issue of Separate Audit Reports and consequential delay in placing them before Parliament/State Legislature.

- (ix) Taking up cases of units with concerned Government, which may be audited under Section 20 (2) of the Audit Act.
- (x) Procurement of sets of Annual Accounts and statement of grants and loans for determining their auditability under relevant Sections of the CAG's (DPC) Act.
- (xi) Compilation of Register of Grants/loans sanctioned to various autonomous bodies/ authorities.
- (xii) Preparation of Cycle Register to have a watch on timely audit of the units under different Sections of the CAG's(DPC) Act and to have effective control over programming,
- (xiii) Sample selection for audit is to be done through "risk analysis and statistical sampling." Matrices have been prepared by Report (State) wing of Headquarters' with various parameters (risk indicators) with an aim to categorise and classify the auditee units particularly for transaction audit in civil and works department. For transaction audit of AB units, these parameters are described in Annexure of CAG's Letter No. 565-Rep(s)/259-2004 dated 16.05.2005, which are mentioned below: -

Risk analysis and Statistical sampling of auditee units for financial transaction audit

Objective: - Classification of the audit units as High risk (H), Medium risk (M) and Low risk (L)

(I) Expenditure: - Principal Indicators (Annual expenditure of second preceding year).

(II) Previous Audit observation (Total amount involved during last three years,)

(III) Internal Control and Internal Audit system (whether functioning satisfactorily)

(IV) Performance Report (Evaluation of performance by internal and external agencies).

### I Expenditure

Weightage	H(6)	M(4)	L(2)
Expenditure on Non-Establishment	₹ 2 crore and above	More than ₹1crore but less than ₹ 2crore	Less than ₹1crore

### II Previous Audit observations

	Weightage	H(6)	M(4)	L(2)
(a)	Money value of Part II A paragraphs in IRs compared to total money value of IRs in last three years.	More than 60 per cent	30 to 60 per cent	Less than 30 per cent
(b)	Outstanding IR paras	Significant number of IR paras pending for more than five years.	Significant number of IR paras pending for three to five years.	Significant number of IR paras pending for less than there years.

### III Internal Control and Internal Audit system.

	Weightage	H(6)	M(4)	L(2)
(a)	Budgetary procedure and expenditure control	Poor	Improvement necessary	Satisfactory control
(b)	Maintenance of records and accounts	Poor	Improvement necessary	Satisfactory maintenance
(c)	Internal Audit	No internal audit conducted	Large arrears in conducting Internal Audit and issue of reports and/ or no follow up of Internal Audit Report.	Satisfactory

#### IV Performance evaluation

Weightage	H(6)	M(4)	L(2)
Performance of units as per Administrative Report of the Department/ Compliance to PAC's recommendations/ Evaluation report on projects/ works/ Department etc if any/ press reports/ complaints.	Poor	Improvement necessary	Satisfactory

Total score [I + II (a+b) +III (a+b+c) + IV] = 10-\*

Categorization of units Low risk- when \* is >2<4

Medium risk >4<5, High risk>5<6

For classification of the units as H, M and L, amount of expenditure may be modified depending on total expenditure of the State and total number of auditee units, However, justification for the modification may be recorded and intimated to the CAG's office with reference to their letter No. 565 rep(s)/259 -2004 dated 16.05.05

- (xiv) Maintenance of programme books in respect of units audited under Sections 19(2) and 19(3) containing complete address, telephone number etc., as per Headquarters instructions for facility of field parties.
- (xv) Keeping watch over completion of audit of all the units dealt with in the wing as per audit plan.

#### II. Administrative functions

- (i) Supply of necessary documents/stationery to field parties.
- (ii) Supply of important instructions/orders/guide lines issued/received by/from Accountant General/ Headquarters, which would be useful in conduct of audit.
- (iii) Verification of T.A. Bills of field parties staff, with reference to the approved tour programme and transmission of the same to Personal Claims Section.
- (iv) Managing disbursement of tour advances to the members of field parties.
- (v) Disposal of leave cases of the staff attached to audit, maintenance of Absentee Register, Leave Sanction Register, etc.

- (vi) Compilation and submission of all periodical returns i.e., monthly arrears report, quarterly and annual arrears report, etc.
- (vii) Selection of staff for Inspection duty and the posting to field parties.

### **III. Other functions of Headquarters Sections**

Other functions of Headquarters' Section are as under:

- (i) Scrutiny, editing and issue of the Inspection Reports received from the field parties. It is to be ensured that all the enclosures, annexures and connected records are enclosed with the Reports. It is also to be ensured that percentage checks at different levels have been completed. The cases of shortfall in quantum of audit should be brought to the notice of Sr. Deputy Accountant General/ Deputy Accountant General Social/Economic Sector and Principal Accountant General/Accountant General (Audit). Audit Inspection Reports should be finalised and issued within a month from the date of completion of audit. Responsibility for ensuring this will rest with the Sections concerned. The directions of the Accountant General (Audit) Uttarakhand to be followed by the field parties and Social Sector (Headquarters) are incorporated as **Annexure- 6** of this Manual.
- (ii) Scrutiny of replies and settlement of paras. In case of outstanding paras, reminders are to be issued at appropriate levels at regular intervals.
- (iii) Maintenance of the following registers in connection with Audit Inspection Reports:
  - (a) Receipt and Issue Register.
  - (b) Progress Register of settlement of Inspection Reports
  - (c) Diary of Inspection Reports.
  - (d) Register of serious financial and other important irregularities for preparing draft paragraphs.
  - (e) Register of special points to be looked into at the time of next audit.

- (iv) To ensure that verification of the old Audit Inspection Reports is done by field parties and no Audit Inspection Report is lost in transit.
- (v) To maintain a programme book in three Sections in cases where no audit of branch units is involved and in four Sections where there are branch units to be audited.
- (vi) Collection of information/material for paras of Part II Section "A" marked by the Sr..Deputy Accountant General/ Deputy Accountant General for processing draft paragraphs.
- (vii) Maintenance and updating of Rules and Regulations, Bye-laws, Memorandum of Association, Articles of Association, format of accounts of all the autonomous bodies in our jurisdiction.

Status of IRs and Paras added and cleared will be shown in the following proforma:

**Status of IRs and Paras added and cleared**

Period quarter ending	Opening Balance		Additions		Clearance		Closing Balance	
	IRs	Paras	IRs	Paras	IRs	Paras	IRs	Paras

Status of Inspection Reports issued will be shown in the following proforma:

**Status of Inspection Reports issued**

Delays in No. of Days								
Year	Total IRs issued	IRs issued in time	1-15	16-30	31-60	61-90	91-150	Beyond 150

Status of Nil Reports will be shown in the following proforma:

**Status of Nil Reports**

Sl. No.		Years			
1.	Total No. of IRs issued				
2.	Total No. of Major objection containing IRs issued				

3.	Total No. of Nil Major objection containing IRs issued				
4.	Nil IRs issued				

**Draft Paragraph cell**

A cell is generally set-up in HQ sections to process the draft paras for inclusion in the Civil Audit Report (State) and coordinating all work relating thereto with the Report Section.

All part II-Section “A” paras appearing in various Audit Inspection Reports or marked by the Sr.Deputy Accountant General/ Accountant General, while approving the reports, should be entered in a Register known as “Potential Draft Paragraph Register” with full particulars of para in the following format:

SI No.	Period of AIR	Dates of Inspection /Name of the unit	No & date of issue of Inspection Report	Para no part II A/B
1	2	3	4	5

Brief subject of Para	Amount	Contributed by	How disposed off.		Remarks if any
			Statement of facts issued vide no & date	Dropped under orders of Group officer	
6	7	8	9		10

After issue of S.O.F. as per column No 9 of PDP register, it will be taken to the SOF Register containing all the relevant information as:-

S No.	Para No.	Period of AIR	Name of the unit	Brief particulars of SOF
1	2	3	4	5

Amount	How disposed of		Contributed by	Remarks if, any
	No & date of D.P issued	Orders of AG vide which dropped		
6	7		8	9

As and when the D.P. is issued, it will be noted in D.P. Register maintained by D.P. Cell. The columns for DP register may be opened to accommodate required information.

The PDP register is required to be submitted to the Principal Accountant General/ Accountant General (Audit) on 1<sup>st</sup> of each month while SOF and DP to the Group Officer with submission memo on the 1<sup>st</sup> page of the Registers and closed as:

Opening balance.....  
 Addition during month.....  
 Total.....  
 Clearance during the month .....  
 Balance at the end of month .....  
 Abstract of clearance  
 SOF/ DP issued .....  
 Dropped.....  
 Total.....

The submission of the Register will be watched through the Sectional calendar of return .

Status of Major Objections considered for Draft Paras will be shown in the following proforma:-

**Status of Major Objections considered for Draft Paras**

	<b><u>YEARS</u></b>			
Total number of major objection issued				
Number of major objections approved as PDP cases				
Number of cases selected for issue of Factual statement.				
Number of Factual statement converted in D.P.				
Number of cases returned to Sections to process them through IRs				

**Inspecting staff**

**I. General:**

The units to be audited by the Inspecting staff of the wing are of complex nature. Besides general scrutiny of transactions and the accounts of a body or authority, the scrutiny of schemes/projects, contracts/ agreements, development programmes etc. is also to be done intelligently. Keeping in view the importance of the audit of schemes and projects etc.,

the Headquarters issued instructions vide D.O letter No. 649/Audit-II/143-85 dated 30.4.1985 on improvement of quality and content of Audit Inspection Reports, wherein stress was laid on the duty of Inspecting officer of the party, who should undertake scrutiny of the original files of works, projects, and schemes. The stress was also laid on the visit of Sr.Deputy Accountant General/Deputy Accountant General/Principal Accountant General/ Accountant General to supervise and guide the field parties conducting audit of such autonomous bodies, whose annual accounts are to be certified and in whose case the Separate Audit Reports are to be prepared for being placed either on the table of Parliament or the State Legislature.

## **II. Composition of field parties.**

Each audit party will consist of two Assistant Audit officers/ one Senior Auditor/Auditor. In case where two Assistant Audit Officers are posted, the senior of the two will be incharge of the party. Generally, the audit parties are supervised by a Sr. Audit Officer/ Audit Officer, who will ensure distribution of work amongst members of the party, besides finalisation of draft Audit Inspection Report and discussion with the Head of the organisation. In case of unsupervised parties, the distribution of work will be done by the party incharge.

## **III. Selection of staff for Inspection Duty**

The work of autonomous bodies is of special and varied nature. As such, the staff engaged on the audit of such bodies should be skilled and experienced so that an effective and efficient audit may be carried out. At the time of selecting staff for audit of autonomous bodies, it is essential to keep in mind that the personnel should be retained in the co-ordination for two or three years and a proper training is imparted to them in order to make them specialized in the audit of bodies or authorities of various nature. The staff should be made conversant with the rules and regulations of audit department as well as of such bodies or authorities for whose audit they are marked.

(**Authority:** Sri S.K. Sastry, Director of Audit's D.O. No. 649-Audit-II/143-85 dated 29.4.85)

#### **IV. Periodicity of Audit**

As per Headquarters instructions, the audit of autonomous bodies is to be taken up annually, but in case of shortage of staff, the periodicity may be determined by the Principal Accountant General /Accountant General. Audit of the bodies or authorities, taken up under Section 19(2), 19(3) and (20(1) of the Audit Act, should be conducted on annual basis. The periodicity of audit under Section 14 of the Audit Act is to be determined by the Principal Accountant General/ Accountant General on the basis of his judgment depending on the adequacy of audit done by the agencies like Director, Local Fund Accounts and the Registrar, Co-operative societies etc.

(**Authority:** Circular No. 6- Audit-II/1986 letter No. 193-Audit-II/143-85 dated 14.2.1986.)

#### **V. Duration of local audit**

The period of audit of any body or authority normally would not exceed 50 working days. The duration of audit is determined on the basis of the nature and scope of activities of the organisation. Where, however, the workload is determined to be heavy, two audit parties may be entrusted to complete the work under supervision of an Inspecting officer.

#### **Duties of party-personnel**

(A) **Sr. Audit Officer/Audit Officer-** The Audit officer incharge of the Inspection party may make certain changes in writing in distribution of work among the party personnel according to the suitability and capacity of the individual official keeping in mind the type of work in hand. He has to be watchful towards achieving efficient performance of the audit party. Besides, he has to perform the following duties:-

(i) He is responsible for ascertaining accuracy in accounting system, procedure for upkeep of proper accounts records, reasons of unrealised revenues and undischarged liabilities, the system of disposal of assets, procedure for making purchases, etc.

(ii) He has to guide the party for achieving good results of audit.

(iii) He will make scrutiny of major schemes/projects involving sizeable investments in such a way that the way of working of the institutions may be depicted. The comments on such matters will be based on the principles of efficiency cum-performance audit.

- (iv) He is responsible for the contents of the Draft Inspection Report.
- (v) He should discuss important points with the Head of Office at the time of finalisation of the Report.
- (vi) He should see that the outstanding paras of the old Audit Inspection Reports are settled to the maximum.
- (vii) He should ensure that the members of the party follow the instructions of the Codes and Manuals of the institution.
- (viii) He should assign himself the scrutiny of the schemes and mounting balances under Sundry Debtors /Creditors.
- (ix) He should select one month for detailed audit in respect of annual units and two months in respect of biennial and triennials units. The orders of the Accountant General (Audit) Uttarakhand regarding selection of test months for detailed checking of the arithmetical accuracy of Cash Books of auditee units are incorporated as **Annexure -7** of this Manual
- (x) In respect of the units incurring expenditure on civil works, the Inspecting Officer will
  - (a) review all regular contracts and agreements finalised during the period of audit;
  - (b) review the system and extent of check exercised by the engineer- in -charge ;
  - (c) review the balance of stock, system of acquisition of stores ;
  - (d) make general scrutiny of muster rolls, schedule of rates etc. ; and
  - (e) check records pertaining to acquisition of land.

**B. Assistant Audit Officer**

The distribution of work to Assistant Audit Officer will be done by the Inspecting Officer or in his absence by the party in-charge. The allotment of work will be as under:

- (i) Audit of the accounts of receipts.

- (ii) Audit of the accounts of stores.
- (iii) General scrutiny of the Cash Book including checking of arithmetical accuracy to the extent prescribed.
- (iv) Examination of the Test Month with supporting documents/records.
- (v) Examination of special points marked for special investigation by the Headquarters office.
- (vi) Details of stores received/purchased under foreign Aid Programme.
- (vii) Scrutiny of unit's Internal Audit Report and verification of old Audit Inspection Reports.
- (viii) Dispatch of the Draft Audit Inspection Report within three days from the date of completion of audit.
- (ix) Scrutiny of the Annual Accounts (Income and Expenditure Account, Receipts and payments Account and Balance Sheet) along with concerned Ledgers and files etc.
- (x) Exercising all checks necessary for certification of accounts.
- (xi) Scrutiny of Bank Reconciliation statement.
- (xii) Scrutiny of Workshop Account, if any.
- (xiii) Scrutiny of press Account, if any.
- (xiv) Scrutiny of subsidy on articles.
- (xv) Analysis of selected works with reference to estimates, agreements etc., and other connected records.
- (xvi) Material at site account.
- (xvii) Checking of contractor's ledgers for selected work.
- (xviii) Scrutiny of old AIRs for settlement of outstanding paras.
- (xix) Checking of Tools and Plant Account.

(xx) Any other work allotted by the Inspecting Officer.

**(C) Allocation of work to Senior Auditor/Auditor**

- (i) Checking of 25% Service Books/Rolls and Leave Account.
- (ii) Checking of Provident Fund Account of employees as per norms.
- (iii) Checking of Pay bills; T.A. bills, Register of undisbursed pay and allowances.
- (iv) Register of Advances, Suspense Account and Deposits.
- (v) Checking of Property Accounts i. e. of land and building etc.
- (vi) Checking of Dead Stock Register, Stamp Account.
- (vii) Checking of vehicles Accounts with reference to Log Books and relevant files, if necessary.
- (viii) Checking of the Records of Books and periodicals.
- (ix) Checking of stationery Account.
- (x) Preparation of Test Audit Note.
- (xi) Dispatching report of work done in shape of weekly diary of work done.

**4.04. Supply of old Audit Inspection Reports and their return**

The field parties should contact the Headquarters section for supply of old AIRs. The Headquarters section should make arrangements to make available the old reports well in time, so that timely verification of replies of outstanding paras may be done by audit parties. Audit parties will return the old Audit Inspection Reports to Headquarters alongwith the AIR of audited unit after conclusion of audit.

**4.05. Supply of Important orders/instructions**

The Coordinating Section at the Headquarters should ensure that important orders and latest instructions are made available to the field parties in order to conduct an effective and efficient audit.

#### **4.06. Supply of forms, stationery, etc**

The field parties will be supplied with the following forms and stationery before making movement:

- (i) A copy of Tour Programme
- (ii) Blank forms of forwarding memos of the draft Audit Inspection Reports
- (iii) Audit pencils for every member
- (iv) Service postage stamps
- (v) Attendance Register
- (vi) Register of work done
- (vii) T. A. Bill forms according to the number of members of the party/ parties conducting audit of the unit
- (viii) Dispatch Register
- (ix) Forms of the application for T.A. Advance according to the number of the member of the party/ parties

#### **4.07. Stamp Account**

The Assistant Audit Officer in-charge of the party should maintain a proper account of service postage stamps if issued to the party prior to making movement from the office. After completion of the quarter, he will render a detailed account of stamps issued, utilised and the balances in hand. The unutilised stamps would be returned to the co-ordinating section, which will ensure that no in-charge of the party is relieved from the Section/Co-ordination or given further movement without rendering the account of service postage stamps issued to him.

#### **4.08. Preprinted Audit Memos**

The Assistant Audit Officer in-charge of the party should maintain a proper account of preprinted Audit Memos issued to the party prior to making movement from the office. After completion of the quarter, he will render a detailed account of preprinted Audit Memos issued, utilised and the balances in hand. The unutilised preprinted Audit Memos would be returned to the co-ordinating section, which will ensure that no in-charge of the

party is relieved from the Section/Co-ordination or given further movement without rendering the account of preprinted Audit Memos issued to him.

#### **4.09. Quarterly Programme**

The co-ordinating Section will draw a Quarterly Tour Programme of the field parties with the help of Skeleton Programme Register as approved by the Principal Accountant General/Accountant General. The following points are to be kept in view while preparing the programme:

- (i) The audit of a body/authority will be booked only when it becomes due according to the fulfillment of the conditions of Sections 14,15,19 and 20 of the Audit Act.
- (ii) The programme is prepared in such a way that maximum number of man-days are utilised and the loss of time in transit is avoided.
- (iii) Assembly of a number of parties at one station is avoided. One party is given the maximum number of units at one station.
- (iv) Sundays and other holidays may be utilised as transit period. In case the distance between two places is less than 100 kms, morning and evening transit may be allowed.
- (v) As far as possible, the units of similar nature are to be covered during the quarter.

The status of auditee units due for audit and actually audited during last four years, status of IRs issued and status of IRs and Paras outstanding above six month will be shown in the following proformas:

#### **Status of auditee units due for audit and actually audited during last 4 years**

<b>Year</b>	<b>No. of auditee units due for audit during the year as per laid down periodically</b>	<b>No. of auditee units planned to be audited during the year</b>	<b>No. of units actually audited</b>

**Status of inspection Reports issued during last 4 years**

<b>Year</b>	<b>No. of units audited during the year</b>	<b>No. of IRs pending to be issued at the beginning of the year</b>	<b>No. of IRs issued during the year</b>	<b>No. of IRs pending at the close of the year</b>

**Status of IRs and Paras outstanding above six months**

<b>Year</b>	<b>IRs</b>	<b>Paras</b>	<b>Money value in ₹</b>

**4.10. Deviation from tour programme**

The field staff should strictly adhere to the approved programme. Normally the party should not alter the programme without prior and specific approval of the Sr.Deputy Accountant General/Deputy Accountant General of the respective sector. In case, where extension of time is must, the reasons and justification thereof may be sent to the Sr.Deputy Accountant General /Deputy Accountant General in advance.

Delay in reporting the amendment of programme will be treated as a serious irregularity. Where the amendment is urgently needed, its intimation should be sent to the Sr.Deputy Accountant General /Deputy Accountant General telegraphically/electronically followed by detailed amendment.

**4.11. Permission to leave place of halt**

No member of the field party should leave the place of halt without previous permission of the Sr.Deputy Accountant General/ Deputy Accountant General (Social/Eco Sector). When, however, a member of the party is forced to leave his place of halt for very strong and urgent reasons, he should report the fact to the Sr.Audit Officer/ Audit Officer in-charge of Coordinating Sector immediately explaining the circumstances which forced him to leave the place of halt or duty in anticipation of formal permission by Deputy Accountant General (Social Sector/Eco Sector).

#### **4.12. Grant of casual leave and restricted holidays**

- (i)** While on inspection, the members of the audit party are not expected to go on regular leave except on grounds of ill health or any other emergent and compelling circumstances. They may avail casual leave under proper sanction of Assistant Audit Officer/Section Officer and Inspecting Officer. Restricted holidays may also be availed of under proper intimation to the sanctioning authority. The casual leave/ restricted holidays application should be sent to respective control Section.
- (ii)** Any tendency to take casual leave at the end of each quarter of audit, during the period the parties remain at Headquarters', should be discouraged. Unless the members have obtained prior permission of Sr.D.A.G/ D.A.G/P.A.G/A.G to avail of casual leave, they are liable to be treated as absent.
- (iii)** No Allowance is admissible to the staff for the period they have enjoyed as casual leave/ restricted holiday including authorised holidays prefixed and/or suffixed there to.
- (iv)** The Assistant Audit Officers are responsible to see that casual leave applications and reports of proceeding on and returning from leave are promptly submitted to the Headquarters.
- (v)** The casual leave register of the audit parties will be maintained by the co-ordinating Section.
- (vi)** In cases of urgency, the AAO in-charge of the party may leave the camp for a day or so, but he must intimate the coordinating Section telephonically. He should also intimate his address during leave.
- (vii)** Where a member of the party applies for leave or the officer in-charge of the party intends to avail himself of leave, party in-charge should send a telephonic intimation followed by written intimation to that effect to the Group officer and keep on the file the record of intimation given.

- (viii) In case a member of the party absents himself without intimation, the fact should be reported by the in-charge of the party on the same day telephonically followed by written intimation to the Group officer and a record kept in the file.
- (ix) No inspecting officer should proceed on earned leave without prior sanction of the Group officer unless it is necessitated on medical grounds, in which case the application must be accompanied by a medical certificate. Applications for extension of leave should also reach (Group officer) well in time for sanction.

#### **4.13. Arrangement during leave**

Whenever a member of the field party proceeds on regular leave for a period exceeding a fortnight, the co-ordinating Section will arrange to post a substitute without delay.

#### **4.14. Observance of holidays by field staff**

The Comptroller and Auditor General has ordered that subject to minor adjustments to suit administrative convenience, every endeavor should be made to ensure that the total number of holidays/closing days enjoyed by the field staff during the calendar year does not exceed that admissible under the orders of Government of India and that there is no short fall in the total number of working hours. As there is variation in the pattern of holidays observed by the State and Central Government offices, the Inspecting and/or Assistant Audit Officer should arrange with the officer concerned of the office inspected to have the office opened on those local holidays, which are not observed at the Headquarters. The gazetted holidays specified in the programme should be strictly followed.

(**Authority:** C.A.G'S letter No. 2492-NGEI/285-65-11 dated 24.8.66 and 208-NGEI-/295II dated 2.2.1967).

#### **4.15. Conduct of officials on Inspection**

All officials and members of staff while on inspection duty, should on no account seek any obligation from the members of the office, which they inspect and should not ask for or obtain free of charge any supply or service, which has financial implications. Help may be sought in getting accommodation, but it should be strictly against payment. The

use of office transport for private purposes is definitely prohibited. Any violation of the orders will attract severe disciplinary action.

#### **4.16. Attitude of Inspecting staff**

The members of the party should be careful to see that no grounds are afforded for complaint from local officers against the manner in which audit is conducted. Audit should be conducted tactfully and with discretion. The auditors should avoid friction with any of the officials with whom they come in contact. They should convince the officers of the body/authority that they are not to complicate the procedure but to simplify it; not merely to criticise, but to assist them. They should point out how a proper check is exercised to avoid possibility of mistakes or omission. They should also bear in mind that unnecessary, meticulous or badly expressed objections bring discredit to audit and cause increase of work at both ends. Objections should be so worded as to bring out the point precisely and briefly. The inspecting staff should, therefore, maintain a strictly detached, dispassionate and technical attitude in day-to-day conduct of their work. Nothing should be done to hamper the evolution of the complementary role of audit and administration either by the use of extravagant language or by the attitude that audit alone is the keeper of the nation's financial conscience.

**(C& AG's D.O. letter no. PS-588 dated 23.10.56)**

#### **4.17. Subject outside the scope of Audit**

The inspecting staff should deal with matters which have financial bearing. Matters, not falling strictly within the scope of audit, should not be touched. Points, which come under the principles of audit, but which cannot be provided for in advance by formal audit rules, as also cases of infringement of the standards of financial propriety, should be investigated. But the inspecting staff should be careful never to encroach upon executive matters nor to take up questions of administration, which have nothing to do with audit and accounts or which are outside the purview of audit.

(Sub-judice matters need not be investigated by audit parties.)

#### **4.18. Accounts not ready for audit**

There is no objection for taking up audit before the accounts are duly approved, but in such cases, the comments of audit on the accounts may be released only after the accounts are duly approved by the competent authority. Having regard to the above guidelines, the constitution of each autonomous body for audit and certification of annual accounts may be examined and the matter taken up with the body /Government, where a system of specific approval is not existing or is not strictly observed. In case such views are not accepted by the body /Government, the matter can be referred to Headquarters with full details.

(**Authority:** No.814-Rep (c)/ 100-B2 dated 25.5.82)

The finalised Audit Report and audit certificate may be issued only after the accounts are approved by the authority competent to approve the same before audit. In cases where the organisation has not accepted the stand taken by audit for approval of accounts before audit, such cases may be specifically referred to Headquarters with full details.

(Authority: No/ 1058-Rep(c)/ 100-82 dated 1.6.1983.)

#### **4.19. Disposal of Anonymous and pseudonymous complaints or notes.**

No action should be taken on anonymous or pseudonymous complaints. Other complaints received relating to matters falling within the purview of audit, should be entered in the Register of special points and made over to the audit party, when it is going to conduct audit of such body/authority, against which the complaint was received. The audit party should verify the points of complaint discreetly with reference to records available locally without giving cause for suspicion.

#### **4.20. Quantum of work to be checked during Local Audit**

<b>Sl. No.</b>	<b>Name of record</b>	<b>Nature of checks to be exercised</b>	<b>Quantum of records</b>
1	Main Cash Book	(i) Arithmetical accuracy	As per sampling plan for local audit
		(ii) Carry forward of balance	-----do-----
		(iii) Tracing of receipts.	-----do-----
		(iv) Tracing of payments:-	-----do-----
		(a) Establishment	-----do-----

		(b)Works expenditure (c)Other expenses	-----do----- -----do-----
2	Subsidiary Cash Books	For all types of work detailed above	-----do-----
3.	Establishment	(i) Correction of pay fixation from time to time:- Service records of Group 'A' , 'B' and 'C' cadre (ii) Correctness of monthly drawls. (iii) Correctness of T.A. paid. (iv) Verification of acquaintance roll. (v) Leave account and service records.	-----do----- -----do----- -----do----- -----do----- -----do-----
4.	Payments of wages	-----	-----do-----
5.	Office contingencies:  (i) Scale regulated  (ii) Others.	(a) Correctness of scales. (b) Correctness of payments. -----	-----do----- -----do----- -----do-----
6.	Purchase of stores single Purchase costing	(i) For general sanction, procedure of purchase, arithmetical accuracy, acceptance etc 'A'. (a) Over ₹ 25,000/- (b) ₹. 10,000/- to ₹ 25,000/- (c) Less than ₹ 10,000/-  (ii) Posting in stock account for purchase issues etc. including correctness of acknowledgements (iii) Physical verification, review stock position, losses etc.	All cases 25% 10%  2 Month
7.	Contract payments for works etc.	Checks to be exercised will include examination of plans, estimates, tenders, Contract, agreements, execution, measurements etc. (i) Contract value exceeding ₹ 2 lakhs (ii) Contract value more then ₹ 50,000/- and upto ₹ 2,00,000/- (iii) Contract value of ₹ 10,000/- to ₹ 50,000/- (iv) .Less than ₹ 10,000/-	All cases  50%  20%

			10%
8	Records Connected with loans	<ul style="list-style-type: none"> <li>(i) Terms and condition.</li> <li>(ii) Execution of bonds and safe custody.</li> <li>(iii) Actual payment vouchers and their safe custody.</li> <li>(iv) Posting in loan ledgers.</li> <li>(v) Correctness of balances and interest calculations.</li> <li>(vi) Acknowledgement of balances.</li> <li>(vii) Maintenance of loan ledgers review of loans files.</li> </ul>	<p>General scrutiny of all cases.</p> <p>20%</p> <p>20%</p> <p>Two months</p> <p>10%</p> <p>10%</p> <p>General</p>
9	Revenue Collection	<ul style="list-style-type: none"> <li>(i) Correctness of assessment and recovery.</li> <li>(ii) Tracing of receipts in subsidiary registers.</li> <li>(iii) Issue of notices for recovery and pursuance.</li> </ul>	<p>10% plus all individual cases in excess of Rs. 1000</p> <p>Two months</p> <p>One month plus General review.</p>
10	Ledger postings	Transfer from Cash Book and other records	Two months plus general scrutiny
11.	Journal entries	Arithmetical accuracy	One month plus general scrutiny.
12	Bank Reconciliation	<ul style="list-style-type: none"> <li>(i) Correctness</li> <li>(ii) Review of items and action taken.</li> </ul>	<p>As on last day of the financial year.</p> <p>General critical scrutiny.</p>
13	Suspense transactions.		General scrutiny of all suspense heads and investment.
14	Investments.		-----do-----
15	Sundry Debtors	<ul style="list-style-type: none"> <li>(i) Acceptance of balances.</li> <li>(ii) Posting of recoveries.</li> <li>(iii) Pursuance of old cases.</li> </ul>	<p>10%</p> <p>One month</p> <p>General scrutiny.</p>
16	Trial balance, Receipts & Payments Account, Income and Expenditure Account and Balance Sheet.	Correctness of entries with reference to subsidiary ledgers and other records.	All items.

17	Charging of Depreciation	(i) Principle (ii) Correctness of charging.	General scrutiny. All, if items are not many, other wise suitable percentage to be locally decided.
18	Account of utilisation of Government Assistance		General scrutiny.
19	Regional provident fund Organisation	(i) Individual P.F.A/c final payment cases  (ii) Checking and tracing of challans in Cash Book.	As per new sampling plan for local audit  -----do-----

(Authority circular No. 20-Audit-II/1985 letter No 782 Audit-II/23-TAI-/84 dated 28.5.1985 and Letter No. Statistical Cell/File No. 05/07-08/2007/01 dt 02.07.2007).

Note: The extent of scrutiny of measurements book and other related records can be decided locally with due regard to facts of each case. 'A' corrected on the basis of CAG's circular No. 35 TA1/82 No 1303/TH/ RGL/ 92-82 dated 6.10.82.

## **CHAPTER-5**

### ***AUDIT OF TRANSACTIONS***

#### **5.01 General**

The audit of transactions will vary from organisation to organisation depending upon the nature of the organisation, the system of accounting and the documents maintained, before actually taking up the audit of transactions of any autonomous body, the first step of the audit party is to examine the adequacy of the accounting system and procedure adopted by it. Cases of misuse or abuse of Public moneys, which point out significant deficiencies in the accounting system and procedures, should be highlighted. However, the points to be examined at the time of audit of various documents or records are detailed, in the succeeding paragraphs.

#### **5.02 Cash Book**

Cash Book is the fundamental record and audit of an organisation commences with the checking of postings in it. The main purpose of auditing the Cash Book is to ensure that:

- (i) all receipts are taken into account in full;
- (ii) no unauthorised or fraudulent payments are made;
- (iii) all receipts and payments are accurately recorded; and
- (iv) the balances are worked out correctly.

For this purpose, the auditor has to see that:-

- (i) the total and balances are correctly computed;
- (ii) balances are correctly carried forward from day to day and from month to month;
- (iii) the balances, in Cash Book, are periodically checked with physical balances and tallied;
- (iv) the receipts are correctly posted in chronological order from all receipt books;
- (v) the payments are duly supported by paid vouchers;

- (vi) withdrawals from and remittances into bank are traced in the respective pass books and also checked from counter foils of cheque books and remittance challans;
- (vii) cash realisations are deposited in bank within the prescribed/ reasonable time;
- (viii) as far as possible, cash receipts are not utilised to meet expenditure and for every payment, withdrawals from the bank are made by means of cheques; and
- (ix) where subsidiary Cash Books are maintained, the transactions therein are duly taken over in the main Cash Book or a system exists where balances of all Cash Books are consolidated and reconciled.

### **5.03. Receipts**

Every autonomous body should have a prescribed procedure for issue and accounting of receipts. It has to be seen in audit that:

- (i) a proper record of receipt books is kept and the books are issued only to persons authorised to issue receipts;
- (ii) the receipts are machine numbered and are issued in chronological order;
- (iii) the return of counter-foils of used/partly used receipt books to safe custody is watched;
- (iv) the receipts are correctly posted in main Cash Book and where they are posted in subsidiary Cash Books, from which totals are taken to main Cash Book, the receipts are correctly posted in these subsidiary Cash Books;
- (v) the revenue realised is correctly assessed, demand notices issued and recovery watched by proper control records with periodical review of these records;
- (vi) the revenue is correctly classified in accounts;
- (vii) in respect of cash received through money orders, cheques and drafts, an effective system of collection and accounting exists and the same is followed;
- (viii) the realisations are duly posted in demand and collection registers and by a cross check, it is ensured that collections as posted in demand and collection registers are duly entered in Cash Book; and

- (ix) loss of revenue is written off under sanction of the competent authority.

#### **5.04. Payment vouchers**

Every payment, entered in Cash Book, has to be supported by a legal acquittance indicating, inter alia, the party to whom the payment has been made, particulars of the transaction to which the payment relates, the period for which the claim relates and dates of payment, duly attested by the person authorised to make the payment. It should be examined in audit that:

- (i) the vouchers are filed in chronological order and are given serial numbers according to well established procedure;
- (ii) the claims are clearly mentioned in the vouchers and are due and admissible;
- (iii) the arithmetical calculations are correctly made;
- (iv) receipts (stamped where necessary) of the claimants are attached to the voucher;
- (v) materials purchased are duly entered in the relevant stores/stock registers and their page numbers are quoted on the payment vouchers;
- (vi) the claim admitted is reasonable for the purchase and sanction for purchase/ payment had been accorded by the prescribed authority ;
- (vii) the vouchers are duly stamped as “Paid” and “Cancelled” to prevent double payment ;
- (viii) payments are, as far as possible, made by crossed cheques ; and if any payment is made in cash, it should be justified ;and
- (ix) the vouchers are correctly classified and duly accounted for.

#### **5.05. Bank Reconciliation**

The bank account in most of the organisations is part of the Cash Book, though separate bank account can also be maintained when most of the receipts and payments are in the form of cheques and drafts, and transactions are carried through the bank. It is necessary in audit to see that the system of bank reconciliation in operation is foolproof and that all receipts are duly posted in bank account and remitted to the bank for realisation and a

watch kept on their due accounting to the credit of the organisation. Similarly, all payments duly discharged by the organisation only are taken to the accounts of the organisation. In particular, the following points need close examination in audit:

- (i) cash receipts are credited to bank at the earliest possible time and counter foils of pay- in- slips are on record ;
- (ii) realisations by cheques /drafts are duly and promptly remitted to the bank and credits appear in bank account ;
- (iii) a system exists for a periodical bank reconciliation and one such reconciliation has actually been carried out as on the date of closure of annual accounts and the statement is properly agreed between the two sets of figures as per Cash Book and as per account in bank ;
- (iv) for the differences between balances as per bank, pass book and Cash Book, action has been taken for the reconciliation of the differences, specially old items ;
- (v) in case of credits in Cash Book which do not appear in pass book, it has to be ensured that pay in slips for actual remittances of such credits to bank are available on record ;
- (vi) there are no payments in bank pass book without corresponding entries in Cash Book and if there is any, it has to be duly investigated to see that it does not indicate any misappropriation ;
- (vii) the cheque books are kept in safe custody and the procedure for issue of cheques in vogue is strictly observed ; and
- (viii) to give a practical idea of bank reconciliation, a table is given below which indicates the possible reasons for the difference between the balance as per bank column of the Cash Book and the balance as per pass book and the method of reconciling the difference.

SI No.	Reasons for differences	Balance as per		Overdraft as per	
		Cash Book	Pass Book	Cash Book	Pass Book
1.	Cheques issued but not presented for payment.	+	-	-	+
2.	Cheques sent to the bank for Collection but not collected.	-	+	+	-
3.	Interest allowed by bank but not entered in Cash Book.	+	-	-	+
4.	Bank charge and interest charge by the bank but not entered in Cash Book.	-	+	+	-
5.	Direct collections by bank but not entered in Cash Book.	+	-	-	+
6.	Direct payments made bank to but not entered in Cash Book,	-	+	+	-
7.	Cheques entered into bank but dishonoured.	-	+	+	-
8.	Cheques entered in Cash Book but not sent to bank.	-	+	+	-
9.	Cheques issued and dishonoured but no entry made for dishonour in Cash Book.	+	-	-	+

#### **5.06 Payment to staff**

The points that require specific examination in audit apart from check of acquittances are as under:

- (i) Are all posts created/ sanctioned by the competent authorities in the prescribed scales?
- (ii) Are appointments made according to the prescribed procedure?
- (iii) Are initial and subsequent pay fixations correctly regulated according to the rules applicable to the autonomous body?
- (iv) Have contributions to provident fund and other funds been computed, realised and accounted for correctly?
- (v) Are leave accounts and other service records being maintained properly?
- (vi) Have leave salary and all allowances given to the employees from time to time been correctly calculated and are admissible?

- (vii) Have recoveries towards income- tax required to be made at source, been correctly made and the amounts remitted to the Income Tax Authorities?
- (viii) In regard to reimbursement of tour expenses, are tours duly sanctioned by the competent authority and claims regulated according to the rules prescribed by the autonomous body. The purpose of the tour should be for and in connection with the activities of the autonomous body.

#### **5.07 Expenditure on wages**

The payments of wage should be checked in audit to see whether:

- (i) a proper record of employment on specified jobs is available along with details of labourers required and actually engaged in a prescribed format ;
- (ii) a proper record of performance of the specified jobs is available ;
- (iii) there exists an assessment of work done vis-à-vis, the expenditure incurred on wages ;
- (iv) the expenditure has been correctly apportioned between capital and revenue ;
- (v) the supervision over the work is adequate ; and
- (vi) the work on which employment was made, was necessary and time taken was reasonable.

#### **5.08 Office contingencies**

Expenditure of a routine nature for the day to day functioning of the office, such as expenditure on stationery, postage, maintenance and running of vehicles, purchase of uniforms to staff, cartage, entertainment expenses, etc. fall under the category of office contingencies. In respect of these transactions, it is necessary to see in audit that:

- (i) a proper record of expenditure under each category is kept ;
- (ii) the expenditure is regulated according to prescribed scales and sanction of the competent authority ;
- (iii) there is adequate justification for abnormal increase in expenditure under certain categories ;

- (iv) a system of proper control over the expenditure by the competent authorities exists ;  
and
- (v) prescribed procedure for incurring the expenditure is observed.

#### **5.09. Stock accounts**

The stock accounts maintained by various autonomous bodies may broadly be classified under the following heads:

- (i) Plants and machinery,
- (ii) Equipment,
- (iii) Raw materials for use in manufacture,
- (iv) Articles purchased for disposal as such,
- (v) Articles manufactured,
- (vi) Articles procured for consumption by the autonomous bodies, and
- (vii) Articles retained permanently for official use.

In respect of the audit of these accounts, it may be seen that:

- (i) there is necessity effecting the purchase for immediate use;
- (ii) the item is utilised for the purpose for which it was purchased;
- (iii) the purchase, issue and consumption are authorised by the competent authority and are according to the prescribed procedure;
- (iv) the purchase and issue are duly taken in the relevant stock registers;
- (v) in case of transfers from one work or Section or department to another, they are duly recorded in the stock registers maintained in respective works, Sections or departments ;
- (vi) the balances are correctly struck and valued ;

- (vii) the physical verification of the ground balance with book balance is carried out periodically and the procedure prescribed for the verification is adequate and duly observed. Shortages should be carefully examined ;
- (viii) there is no excessive accumulations of the stock ;
- (ix) old and obsolete stocks are identified and disposed off in time according to the prescribed procedure ;
- (x) the procedure prescribed for making purchases is sound and is duly observed ;
- (xi) comparative statements, where tenders are invited and the recommendations of the purchase committee set up for the purpose should be carefully examined; reasons for rejection of the lowest tender should be invariably enquired and analysed ;
- (xii) the purchases are made at most economical time and rate, consistent with the quality and the quality of supply is checked with reference to declared quality in the agreement for supply ;
- (xiii) the disposals are made at rates properly worked out and approved by competent authority ;
- (xiv) the procedure for custody of various articles of stock has been prescribed and is duly observed ;
- (xv) consumption of materials in production or otherwise has been in conformity with the prescribed scales ;
- (xvi) valuation of products for taking to stock, accounting of issues and stock taking has been done according to prescribed procedures and the procedures themselves are fair and reasonable ; and
- (xvii) record of depreciations in value accounts is properly kept and rates charged are adequate.

It should be particularly borne in mind that in the case of organisations which do not earn revenue of their own, no depreciation needs to be written off till the assets exhaust their useful life or till they are disposed off.

### **5.10. Expenditure on works**

Expenditure on works means the expenditure on the execution of a project as a whole or execution of individual works or works relating to maintenance and repairs, both regular and special. The works are, in certain autonomous bodies, executed by themselves with the help of their own-wing of engineers, while in others, either through the state or Central Public Works Departments or through architects. The accounting procedure adopted by the autonomous body will have to be examined; by and large, it is similar to that adopted by Government Public Works Divisions. Instructions given in the Manual of Standing Orders (Technical) Volume-I relating to the audit of Government Public Works Divisions may be applied mutatis mutandis for audit of works transactions of autonomous bodies as well. In addition, the following points may be examined in audit:

- (i) Whether the project has been approved by the competent authority of the autonomous body and the financing authority, viz. State or Central Government, University Grants Commission, etc?
- (ii) Whether any time schedule for implementation of the project has been drawn up, indicating the physical and financial target from time to time and whether the same has also been agreed to by the funding authority?
- (iii) Whether for the several components of the projects; required detailed plans and estimates have been drawn up in time, duly approved by the competent technically qualified authority specified for the purpose?
- (iv) Whether the execution of the works was taken up as planned and whether flow of funds was as anticipated; if not, how far the works, suffered may be looked into. Abandoned works, if any, due to paucity of funds, may be examined in depth?
- (v) Whether the detailed drawings and designs, where required, were drawn up in time and furnished to the executing authorities and if not, reasons for delay should be ascertained in audit?
- (vi) Whether a proper procedure for finalisation and award of contract is laid down and the same is duly observed? Whether the agreement contains a penalty clause to take

action against the contractor in case of any default made by him resulting in loss to the autonomous body?

- (vii) Whether tenders have been invited after giving wide publicity and whether they were properly scrutinized and comparative statements prepared before accepting the lowest tender? In case of acceptance of tender other than the lowest, justification for this, need be seen in audit?
- (viii) Whether the delays, if any, at various stages viz, preparation of plans and estimates, supply of detailed drawings and designs to the executing agency, invitation and acceptance of tenders and supervision of works in execution have resulted in any loss, not only for the work as such, but also to the development of the organisation itself or in the execution/implementation of projects/schemes taken up by the autonomous body? Escalation of cost due to delay may be examined?
- (ix) Whether payments to contractors were made in time according to the agreement and whether any unauthorised aid to the contractor involved?
- (x) Whether records of measurement of the works at various stages have been maintained properly and whether the measurements have been taken in time by the qualified/competent persons? Whether such measurements are adequate suppository check? Register of measurement books should be examined to ensure proper account and return of unused books?
- (xi) Whether quantities of work executed are within the estimates and variations are examined and justified?
- (xii) Whether the extra items executed are such that they could not be anticipated and not those omitted from plans and estimates for tendering and whether the rate paid for them has been correctly assessed in accordance with the contract?
- (xiii) Whether a proper record of completion of the works is maintained and quality of work is subjected to adequate test, according to prescribed procedure and terms of contract?

- (xiv) In case of poor quality of work detected on inspection at the time of completion, it may be examined why it could not be noticed earlier by the authority supervising the work and recording the measurement;
- (xv) In respect of contracts on “cost plus percentage” basis, the control on quantity of work is quite adequate and there are no avoidable increases in quantity and there are no instances of use of costly items of work as substitution, resulting in avoidable increase in cost and consequent increase in contractor’s commission;
- (xvi) In cases of contract with architects, whether the terms of agreement are properly drawn up to protect the autonomous body against wasteful expenditure, lack of timely supervision by him and compensation for losses attributable to failures by architect etc ;
- (xvii) In case, the autonomous body is not in a position to commence work due to one reason or the other, such as non-availability of land, plans and estimates, non-invitation of tenders, etc. whether the funds for the work are not obtained from Government far in advance of the needs. If received in advance, their utilisation/ deviation may be looked into in audit;
- (xviii) In respect of expenditure on maintenance and repairs, whether they are reasonable and necessary and are not for the removal of defects in initial execution on which timely action had not been taken;
- (xix) Whether proper materials-at-site accounts are kept, all receipts and issues noted, whether surplus material is not procured just for the sake of utilisation of the budget provisions, whether control on stock is kept and unused materials at the end of a work are duly transferred to stock/other works etc. or otherwise disposed of?
- (xx) Whether the works executed are utilised for the purpose for which they were carried out;
- (xxi) Work orders for petty works carried out without invitation of tenders should be examined to ensure that the works were not split up to evade invitation of tenders or sanction of a particular authority, proper up keep and safe custody of records regarding work orders should be checked in audit;

(xxii) Whether tenders received are accompanied by adequate earnest money and adequate security deposit is received from the contractors before awarding works to them? Whether mode of security deposit is in accordance with the prescribed rules?

### **5.11. Advances to employees**

A system of payment of advance is in vogue in every autonomous body for the day to day management and administration. In all such cases, advances should not be booked to the final heads of accounts, ab-initio; otherwise adequate control over their adjustments will be lost. Advances of this nature should be booked as such in the accounts. As and when advances are adjusted, suitable book adjustment must be carried out to transfer the advance to final head and the unadjusted advance at the end of the year should be reflected in the Balance Sheet clearly.

Advances to employees can be in the nature of advances for festival, tour, purchase of conveyance, construction of house, procurement of materials, works under execution, payments to be made by the employee on behalf of the autonomous body etc. In respect of advances for festival, purchase of conveyance, construction of houses, etc., entitlement amount payable and amount recoverable from month to month are according to the prescribed rules/ procedure.; recoveries in these cases must be regular and it has to be ensured in audit that a proper system is prescribed and the same is duly observed. In respect of tour advances, it has to be seen that the amount of advance is not in excess of the anticipated tour claims, tours are duly sanctioned by the competent authority, adjustment bills are obtained immediately after the tour is over, and adjustments are duly carried out by recoveries of excess payment in lump.

In regard to advances for procurement of materials, disbursements to be effected on behalf of the autonomous body, etc., it should be seen in audit that no subsequent advances are given without adjustment of the previous advance and that the internal check and control over them are quite adequate. In particular, it should be seen in audit that:

- (i) the advance was for meeting immediate disbursement and was limited to the anticipated expenditure;

- (ii) the advances were duly authorised by the competent authority;
- (iii) the date by which expenditure was to be incurred was known and an account for adjustment had been rendered immediately;
- (iv) a proper record of such advances is kept and recovery/adjustment is watched through it;
- (v) amount remaining unutilised had been promptly refunded and was not allowed to remain with the official for long, particularly when the amount is a substantial one;
- (vi) a proper account was received and recovery had been effected in all cases before the officials concerned proceeded on leave, transfer, retirement, etc., and
- (vii) the materials purchased, if any, out of such advances, were duly authorised by the competent authority and taken to stock.

#### **5.12. Advances to suppliers and contractors**

In the same way as advances to employees, it is necessary that the advances to suppliers and contractors should also be booked in accounts as advances only and final adjustment made on receipt of accounts/ materials/or after completion of works. No advance should be made to suppliers and contractors unless payment of such advance has been permitted under the terms of the contract or authorized under the trade practice in vogue for supply. In all such cases, it has to be seen in audit whether:

- (i) the terms of agreement provide for payment of the advance:-
- (ii) the terms of contract provide for adequate protection to the autonomous body for claiming the advance back with penalties in the event of breach of contract;
- (iii) the advance is limited to the minimum admissible and is not paid for a longer time than prescribed;
- (iv) a proper record of such advances is kept and recovery adjustment is watched through it;

- (v) adequate provision exists in the agreement for inspection of material/work for which advance is paid and the provisions are scrupulously observed;
- (vi) in cases of non-adjustment of advances within the prescribed time, action for recovery is initiated in time in accordance with the terms of the contract; and
- (vii) in respect of running contracts for works/supply and payment of advances, a periodical settlement of account is done and balances are duly accepted by either parties.

**5.13. Loans raised by the autonomous bodies:**

Loans may be raised by the autonomous bodies, under the sanction of the competent authority, either for general purposes or for certain specified purposes. In such cases, it should be seen in audit whether:

- (i) sanction for raising the loan has been obtained from the competent authority ;
- (ii) there is ample justification for raising the loan up to the level, in view of the financial position of the autonomous body;
- (iii) the purpose for which loan is to be raised is determined and the loan has been utilised for that purpose;
- (iv) the loan is not raised far ahead of the schedule or in excess of needs, resulting in its diversion for other purposes or in investments;
- (v) the paying capacity of the autonomous body has been duly assessed with reference to the source of income from which the repayment of the loan is to be met and the source is actually available for repayment;
- (vi) the repayment of loan and interest is not met by obtaining grants for the purpose, unless it is specifically authorised by the grant sanctioning authority;
- (vii) the terms and conditions of the loan are clearly determined and copy of the same is available with the loanee;
- (viii) the interest payable is correctly worked out and is duly reflected in accounts whether paid or not;

- (ix) the loan is utilised for the specified purpose and any surplus is duly refunded, if permissible;
- (x) a proper record of the loan is maintained for watching its timely repayment and the record is duly reviewed; annual balance is accepted by the loan giving agency; and
- (xi) all matters relating to raising of loan, utilisation, finalisation of terms and conditions, position of repayment, etc., are brought to the notice of the main governing body other committees from time to time.

#### **5.14. Loans disbursed by the autonomous bodies**

While scrutinising disbursement of loan by the autonomous body, following points should be examined in audit whether:

- (i) the scheme for grant of loan has been authorised by the Management and Government where necessary;
- (ii) the source for financing has been duly determined;
- (iii) the terms and conditions are duly settled and a proper agreement is made with the loanee ;
- (iv) the loan agreement deeds are duly registered, where necessary, and kept in safe custody ;
- (v) loans are paid only to those who are eligible under the scheme after fulfillment of the required conditions;
- (vi) capacity of the loanee for repayment of loan installments has been assessed before payment of the loan to him;
- (vii) demand notices are issued well in time for recovery of principal and interest and matter pursued according to terms and conditions of the loan till final recovery;
- (viii) submission of periodical report on utilisation of loan for specific purpose has been prescribed by the autonomous body and recovery of unutilised portion of loan is made in time

- (ix) acceptance of balances is obtained annually from each loanee;
- (x) records relating to loan are properly maintained, reviewed periodically at an appropriate level and action taken for repayment, where necessary; and
- (xi) outstanding installments of loan and interest have been shown in the annual accounts.

#### **5.15. Grants received by the autonomous bodies**

Grants received by the autonomous bodies are of two kinds: recurring for meeting expenditure on its maintenance or execution/implementation of schemes/ programmes and; non-recurring-for acquisition of certain capital assets. One of the basic points to be seen in the accounts of any autonomous body is to ensure that the format of the accounts indicates the source of each grant and its utilisation for specified purposes. It may be noted here that transactions of all the grants must be included in the annual accounts itself, of course, under the separately identifiable heads of accounts but separate annual accounts are not maintained for each grant because due to ignorance of their existence, certain accounts may not be made available to audit. Scrutiny of transactions relating to payment of grant and its utilisation is one of the most important aspects of audit of autonomous bodies. While scrutinising these transactions, the following points should necessarily be looked into in audit:

- (i) The amount of grant payable to the autonomous body for each purpose has been correctly assessed after taking into account all income adjustable towards limiting of the grant, in accordance with the guidelines, rules and prescribed procedures for assessment of the grant.
- (ii) In respect of maintenance grants, it is restricted to the net deficit and the expenditure on several items has been incurred in accordance with the scales laid down therefore.
- (iii) Grants remaining unutilised at the end of each year had been duly taken into consideration before determining the grant payable in the subsequent years and the amount paid was not far in excess or advance of the requirements.

- (iv) The conditions attached to the grant, before and after release are duly fulfilled.
- (v) The prescribed periodical returns are correctly compiled and supplied and a review there of does not point out any deviation of purpose of grant or irregularities in utilisation.
- (vi) The assets acquired out of grant are continued to be utilised for the intended purpose and obsolete assets are disposed of and realisations credited to Government/ funding authority or adjusted against future grants.
- (vii) The objectives of the schemes for which grants are paid, are being achieved and a periodical review is being conducted, with the knowledge of the grant sanctioning authority for assessing the progress, future needs and changes and due approval is taken for modifications, increase in cost, etc.
- (viii) The income, expected to be generated by assets acquired and schemes executed in past with the grants received from Government, is actually being realised and the maintenance grant has been reduced to that extent, if so anticipated.

#### **5.16. Assurances given by the autonomous bodies**

There are certain autonomous bodies like the University Grants Commission, Indian Council of Agricultural Research, Khadi Boards etc., which like Government, give financial assistance to several organisations and individuals for specified purposes. The instructions given in the Manual of Standing Orders (Audit) on audit of financial assistance rendered by Government, apply mutatis mutandis for audit of such assistance rendered by the autonomous bodies with such modifications, as may be called for. The paragraph 2 of Chapter 2 of this manual may also be referred to.

#### **5.17 Transactions relating to sundry debtors**

Certain autonomous bodies, like Khadi Boards and Housing Boards etc., undertake credit sales of their products/ properties and realize their income later in accordance with the prescribed procedures. In such cases, it is necessary to see that a proper accounting procedure is established and is strictly followed and the credit sales are duly accounted for immediately after the transaction take place. A proper ledger for such parties with

whom the autonomous body has credit dealings is to be maintained, essentially, While scrutinising the ledger, it has to be seen that at the end of the year, the balances as per the individual ledger are duly drawn and agreed with the balances under the head “Sundry Debtors” as reflected in the Balance Sheet. Besides, it should be seen in audit that:

- (i) the credit sales are authorised by competent authority and the credit worthiness of the debtor was considered before effecting credit sales;
- (ii) the terms and conditions for credit sales have been prescribed and observed both by the autonomous body and the purchaser;
- (iii) amount due for realisation had been correctly assessed and adjusted in account;
- (iv) periodical demand notices are issued for recovery in time and recovery proceedings adequately pursued and appropriate action taken against defaulters;
- (v) if the recovery is made on installments basis, it should be seen in audit that the amount of installments along with interest has been duly received and accounted for. The amount of interest should be shown separately in the account so that the balance of outstanding principal amount can be ascertained and pursued;
- (vi) proper mortgage deals should be executed and got registered wherever required;
- (vii) a system of annual acceptance of balance by the debtor is in vogue and is being observed; and
- (viii) a periodical review of old cases is being conducted and appropriate action taken by the autonomous body.

#### **5.18. Records relating to sundry creditors**

Certain autonomous bodies purchase materials on credit basis and settle the accounts periodically. In such cases, it is to be seen in audit that the autonomous body had made purchases on credit according to specific directive and no irregularity had been committed by taking recourse to credit purchases. It is also necessary to ensure that all credit purchases are promptly taken into account and a proper record of creditors is maintained and reviewed periodically. Balances in the ledgers duly agree with the balance shown under the head. “Sundry Creditors” in the Balance Sheet.

### **5.19. Creation and investment of fund by the autonomous bodies**

Where certain autonomous bodies create certain funds e.g. Depreciation Reserve Fund, Reserve Fund etc., as required under the law, rules and regulations etc, governing the autonomous body and invest them in Government securities, it has to be seen in audit that:

- (i) allocation of the amount to the fund concerned is in accordance with the rules governing the fund;
- (ii) the fund is being accumulated in accordance with the prescribed scales and is not in excess of the prescribed ceiling;
- (iii) the investment of the fund money should be made according to the rules applicable to the fund and it should be made only out of allocated surplus and not out of loan realised unless it is specially authorised;
- (iv) the investment has been made in accordance with the prescribed pattern and the procedure for investment is duly authorised by the competent authority, but any loss to the autonomous body on this account should be avoided;
- (v) the interest earned on investments is not appropriated to revenue unless otherwise authorised, but is allowed to increase the balance of the fund only;
- (vi) the accumulations in investments are duly matched periodically with fund balances and where required, the shortfall in fund should be made good, and
- (vii) excess receipt of Government grant/loan or receipt far in advance of needs of the fund is returned to Government and not diverted towards investment.

### **5.20. Scholarships, stipends and such other payments**

Several autonomous bodies obtain funds from Government and other autonomous bodies like the University Grants Commission, Council of Scientific and Industrial Research, Indian Council of Agricultural Research, etc. for payment of scholarship, stipend, etc., for conducting higher studies by selected personnel or for implementing specified research schemes. In respect of all such payments, it is necessary to examine in audit that:

- (i) the period for which the scheme is to run is clearly specified in the sanction of that scheme;
- (ii) the selection of personnel is made according to the prescribed rules and regulations governing the schemes;
- (iii) adequate precautions are provided for to guard against midway drop outs, resulting in infructuous expenditure;
- (iv) a system of monitoring and periodical check up on progress of the execution of the scheme has been provided for in the scheme and the same is observed without any avoidable delay;
- (v) an assessment of the results achieved by the beneficiaries is invariably made on the completion of the course of training or scheme;
- (vi) extensions for schemes are applied for in time, are examined and sanctioned by prescribed authorities after due evaluation of the progress and the necessity for continuance; and
- (vii) results achieved by the schemes are duly utilised in the specified areas and their general utility is assessed periodically before their continuance.

### **5.21 Provident fund accounts of the employees**

Most of the autonomous bodies maintain the provident fund accounts of their employees themselves. In all such cases, it is essential to ensure that the autonomous body has framed proper rules and regulations for maintenance of these accounts and the provident fund is duly recognised by the competent authority, otherwise the contributions to the fund by the employees may not qualify for rebate under the Income Tax Act. It should be ensured in audit that terms and conditions governing the recognition of the fund are duly observed from time to time. In particular, following points are to be seen in audit of transaction relating to provident fund accounts:

- (i) The contributions to the fund both by the employer ( in the case of contributory scheme) and the employees have been made according to the prescribed rates, the increase or decrease in rate of the contribution being strictly regulated in

accordance with the rules and are recovered regularly, and credited to the subscriber's accounts.

- (ii) Refundable or non-refundable withdrawals are duly authorised for the specified purposes according to prescribed scales and refund of withdrawals are also made as per rules.
- (iii) It should be ensured that all the employees, who come under the scheme of provident fund, start contributing in time as per prescribed rules.
- (iv) The interest due to each account is correctly calculated at the rates prescribed under the rules and credited at the end of each year.
- (v) Investment of the balances lying in the accounts of the subscribers is made as per rules/ regulations authorised by Government while granting approval to the scheme of the fund.
- (vi) The interest on investments is realised in time and is correctly accounted for on accrual basis in the annual accounts.
- (vii) The balances in each subscribers accounts at the end of each year duly worked out, communicated to the subscriber and his acceptance obtained.
- (viii) The balance in all subscribers' accounts are duly drawn up in a prescribed schedule and the total outstanding balance as shown in the schedule is reconciled with the balances as shown in the annual accounts.
- (ix) The balance of Provident Fund Account comprising the balances in all subscribers' accounts has been correctly drawn up separately in the form of investments, recoverable advances to subscribers and cash and bank balances.
- (x) The directions of the Accountant General (Audit) Uttarakhand regarding scrutiny of the records relating to GPF are reproduced as **Annexure-8** of this Manual.

## **5.22 Audit against provision of funds**

It is essential that every autonomous body prepares an annual budget indicating various sources of income, anticipated income from the several sources, the expenditure proposed

to be incurred against several heads of account, both revenue and capital. The budget so prepared must be approved by the apex body of the autonomous body in the annual meeting and where necessary, a revised budget for the year in progress is also prepared and approved. Where so provided, copies of budget would also be sent to Government and their approval obtained, if so required. In audit, it has to be seen whether these requirements have been complied with and in addition, it should be seen that:

- (i) a proper control record is kept by the autonomous body to watch the progress of income and expenditure against budget provisions:-
- (ii) the variations between actual and budget provisions (excesses and savings under different heads) are examined at appropriate levels, remedial action taken, where called for and reappropriations approved by competent authorities;
- (iii) the final receipts and expenditure under several heads of account at the end of the year are examined with reference to final appropriations and variations are brought to the notice of the apex body for information and regularisation, where necessary.
- (iv) It has been ensured that the transactions are correctly classified in accounts under appropriate heads of accounts in accordance with the budget provisions and also general rules and regulations relating to classification of transactions.

### **5.23. Correction of accounts**

Correction of accounts should not be insisted as a matter of course for rectification of every mistake, noticed in audit. The request for correction should be made only sparingly in cases where the autonomous body is either willing to carry out the correction without delay to avoid audit comment or the corrections are such that they affect the fundamental accuracy of the accounts to be certified. In cases, where the autonomous body promises to carry out the corrections in future accounts, it should normally be agreed to. But, where the accounts for the current year can not be certified in view of the mistakes pointed out in audit and not rectified by the body, it should specifically be mentioned that audit is not in a position to certify that the current year's accounts represent true and fair picture of autonomous body.

## **CHAPTER-6**

### ***INTERNAL CONTROL STANDARDS***

#### **6.01 Internal Control**

##### **➤ Definition**

An internal control is an integral process that is effected by an entity's management and personnel and is designed to provide reasonable assurance that the following general objectives are being achieved:

- fulfilling accountability obligations;
- complying with applicable laws and regulations;
- executing orderly, ethical economical, efficient and effective operations; and
- safeguarding resources against loss.

Internal control is a dynamic integral process that is continuously adapting to the changes an organisation is facing. Management and personnel at all levels have to be involved in this process to provide reasonable assurance of the achievement of the objectives.

##### **➤ An Integral process**

Internal control is not one event or circumstance, but a series of actions that permeate an entity's activities. These actions occur throughout an entity's operations on an ongoing basis. They are pervasive and inherent in the way the Management runs the organisation. Internal control is therefore different from the perspective of some observers who view it as something added on to an entity's activities, or as a necessary burden. The internal control system is intertwined with an entity's activities and is most effective when it is built into the entity's infrastructure and is an integral part of the essence of the organisation. Internal control should be built in rather than built on. By building in internal control, it becomes part of and integrated within the basic management processes of planning, executing and monitoring. Built in internal control also has important implications for cost containment. Adding new procedures that are separate from existing ones add costs. By focusing on existing operations and their contribution to effective

internal control, and by integrating controls into basic operating activities, an organisation can often avoid unnecessary procedures and costs.

➤ **Effected by management and other personnel**

People are what make internal controls work. Same is accomplished by individuals within an organisation, by what they do and say. Consequently, internal control is effected by people. People must know their roles and responsibilities, and limits of authority.

An organisation's people include the Management and other personnel. Although the Management primarily provides oversight, they also set the entity's objectives and have overall responsibility for the internal control system. As internal controls provide the mechanisms needed to help understand risk in the context of the entity's objectives, the Management will put internal control activities in place and monitor and evaluate them. Therefore internal control is a tool used by the management and directly related to the entity's objectives. As such, Management is an important element of internal control. However, all personnel in the organisation play important roles in making it happen.

Similarly, internal control is affected by human nature. Internal control guidelines recognize that people do not always understand, communicate or perform consistently. Each individual brings to the workplace a unique background and technical ability, and has different needs and priorities. These realities affect, and are affected by, internal controls.

➤ **Provides reasonable assurance**

No matter how designed and operated, internal controls cannot provide Management absolute assurance regarding the achievement of an entity's objectives.

Reasonable assurance equates to a satisfactory level of confidence under given considerations of costs, benefits and risks. Determining how much assurance is reasonable requires judgment. In exercising that judgment, managers should identify the risks inherent in their operations and the acceptable levels of risk under varying circumstances, and assess risk both quantitatively and qualitatively.

Reasonable assurance reflects the notion that uncertainty and risk relate to the future, which no one can predict with certainty. Also factors outside the control or influence of the organisation can affect the ability to achieve the objectives. Limitations also result from the following realities: human judgment in decision making can be faulty; breakdowns can occur because of simple errors or mistakes; controls can be circumvented by collusion of two or more people; Management can override the internal control system; and decisions on risk responses and establishing controls need to consider the relative costs and benefits. These limitations preclude Management from having absolute assurance that objectives will be achieved.

Reasonable assurance recognizes that the cost of internal control should not exceed the benefits derived. Cost refers to the financial measure of resources consumed in accomplishing a specified purpose and to the economic measure of a lost opportunity, such as a delay in operations, a decline in service levels or productivity, or low employee morale. A benefit is measured by the degree to which the risk of failing to achieve a stated objective is reduced. Examples include increasing the probability of detecting fraud, waste, abuse, or error; preventing an improper activity; or enhancing regulatory compliance.

Designing internal controls that are cost beneficial while reducing risk to an acceptable level requires that managers clearly understand the overall objectives to be achieved. Government managers may design systems with excessive controls in one area of their operations that adversely affect other operations. For example, employees may try to circumvent burdensome procedures, inefficient operations may cause delays, excessive procedures may stifle employee creativity and problem solving or impair the timeliness, cost or quality of services provided to beneficiaries. Thus, benefits derived from excessive controls in one area may be outweighed by increased costs in other activities.

➤ **Achievement of objectives**

Internal controls are geared to the achievement of a separate but interrelated series of general entity level objectives. These general objectives are achieved through numerous specific sub-objectives, functions, processes, and activities.

The general objectives are discussed below:

➤ **Fulfilling accountability obligations**

Accountability is the process whereby public service bodies and the individuals within them are held to account for their decisions and actions, including their stewardship of public funds, fairness, and all aspects of performance.

This will be realized by developing and maintaining reliable and relevant financial and non-financial information and by means of a fair disclosure of that information in timely reports to internal as well as external stakeholders.

Non-financial information may relate to the economy, efficiency and effectiveness of policies and operations (performance information), and to internal controls and their effectiveness.

➤ **Complying with applicable laws and regulations**

Organisations are required to follow many laws and regulations. Examples include the Budget Act, International treaties, laws on proper administration, accounting law, environmental protection, civil rights law, income tax regulations, anti-fraud and anti-corruption acts.

➤ **Executing orderly ethical, economical, efficient and effective operations.**

The entity's operations should be orderly, ethical, economical, efficient and effective. They have to be consistent with the organisation's mission.

Orderly means in a well organized way, methodically.

Ethical relates to moral principles. The importance of ethical behavior and prevention and detection of fraud and corruption in the public sector has become more emphasized since the nineties. General expectations are that public servants should serve the public interest with fairness and manage public resources properly. Citizens should receive impartial treatment on the basis of legality and justice. Therefore, public ethics are a prerequisite to, and underpin public trust, and are a keystone of good governance.

Economical means not wasteful or extravagant. It means getting the right amount of resources, of the right quality, delivered at the right time and place, at the lowest cost.

Efficient refers to the resources used to achieve the objectives. It means the minimum resource inputs to achieve a given quantity and quality of output, or a maximum output with a given quantity and quality of resource inputs.

Effective refers to the accomplishment of objectives or to the extent to which the outcomes of an activity match the objective or the intended effects of that activity.

➤ **Safeguarding resources against loss due to waste, abuse, mismanagement, errors, fraud and irregularities**

Although the fourth objective can be viewed as a subcategory of the third one (orderly, ethical economical, efficient and effective operations), the significance of safeguarding the resources in the public sector needs to be stressed. This is due to the fact that budgetary accounting or accounting on a cash basis, which is still widespread in the public sector, does not provide sufficient assurance related to the maintenance of records of the resources. As a result, the organisations in the public sector do not always have a record of all their assets, which makes them more vulnerable. Therefore, controls should be embedded in each of the activities related to the management of resources of the entity, from the entry until the disposition.

Other resources such as information, source documents and accounting records are also in danger of being stolen, misused or accidentally destroyed. Safeguarding certain resources and records has become increasingly important since the arrival of computer systems. Sensitive information stored on computer media can be destroyed or copied, distributed and abused if care is not taken to protect it.

➤ **Limitations on internal control effectiveness**

- **Internal control cannot by itself ensure the achievement of the general objectives defined earlier.**

An effective internal control system, no matter how well conceived and operated, can provide only reasonable not absolute assurance to Management about the achievement of an entity's objectives or its survival. It can give the Management, information about the entity's progress, or lack of it, toward the achievement of the objectives. But internal control cannot change an inherently poor manager into a good one. Moreover, shifts in

government policy or programs, demographic or economic conditions are typically beyond Management's control.

An effective system of internal control reduces the probability of not achieving the objectives. However, there will always be the risk that internal controls fail to operate as designed.

Because internal control depends on the human factor, it is subject to flaws in design, errors of judgment 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. Maintaining an internal control system that eliminates the risk of loss is not realistic and would probably cost more than is warranted by the benefit derived. In determining whether a particular control should be established, the likelihood of the risk occurring and the potential effect on the entity are considered along with the related costs of establishing a new control.

Organisational changes and management attitude can have a profound impact on the effectiveness of internal control and the personnel operating the system. Thus, management needs to continually review and update controls, communicate changes to personnel, and set an example by adhering to those controls.

*Note: The limitations on internal control effectiveness need to be stressed to avoid exaggerated expectations due to a misunderstanding of its effective scope.*

## **6.02 Components of Internal Control**

Internal control consists of five interrelated components:

- control environment
- risk assessment
- control activities
- information and communication
- monitoring

Internal control is designed to provide reasonable assurance that the entity's general objectives are being achieved. Therefore, clear objectives are a prerequisite for an effective internal control process. The control environment is the foundation for the entire internal control system. It provides the discipline and structure as well as the climate which influences the overall quality of internal control. It has overall influences on how strategy and objectives are established and control activities are structured.

Having set clear objectives and established an effective control environment an assessment of the risks facing the entity as it seeks to achieve its objectives provides the basis for developing an appropriate response to risk.

The major strategy for mitigating risk is through internal control activities. Corrective actions are a necessary complement to internal control activities in order to achieve the objectives. Control activities and corrective actions should provide value for money. Their cost should not exceed the benefit resulting from them (cost effectiveness).

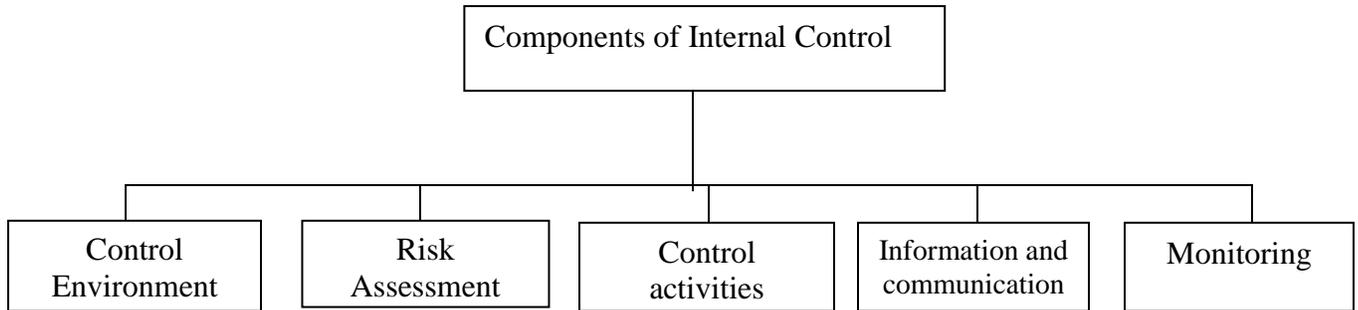
Effective information and communication is vital for an entity to run and control its operations. Entity management needs access to relevant, reliable, timely communication related to internal as well as external events. Information is needed throughout the entity to achieve its objectives.

Finally, since internal controls are dynamic processes that have to be adapted continuously to the risks and changes an organisation faces, monitoring of the internal control system is necessary to ensure that the internal controls remain tuned to the changed objectives, environment, resources and risks.

These components define the recommended approach for internal controls in government and provide a basis against which internal controls can be evaluated. These components apply to all aspects of an organisation's operation.

These guidelines provide a general framework. When implementing them, Management is responsible for developing the detailed policies, procedures, and practices to fit their organisation's operations and to ensure that they are built into and are an integral part of those operations.

## Relationship of objectives and components



There is a direct relationship between the objectives, which represent what an entity strives to achieve, and the internal control components, which represent what is needed to achieve them. The relationship is depicted in a three-dimensional matrix.

The four objectives- accountability (and reporting) compliance (with laws and regulations), (orderly, ethical, economical, efficient and effective) operations and safeguarding resources are represented by the vertical columns, the five components are represented by horizontal rows, and the organisation or entity and its departments are depicted by the third dimension of the matrix.

Each component row "cuts across" and applies to all four objectives. For example, financial and non financial data generated from internal and external sources, which belong to the information and communication component, are needed to manage operations, to report and fulfill accountability purpose, and to comply with applicable 1

Similarly, looking at the objectives, all five components are relevant to each objective. Taking one objective e.g. effectiveness an efficiency of operations, it is clear that all five components are applicable and important to its achievement.

Internal control is not only relevant to an entire organisation but also to an individual department. This relationship is depicted by the third dimension which represents entire organizations, entities and departments. Thus, one can focus on any of the matrix's cells.

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 organisational 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.

In the following text, each of the abovementioned components is presented concisely with additional comments:

### **Control Environment**

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

Elements of the control environment are:

- (i) the personal and professional integrity and ethical values of the management and staff including a supportive attitude toward internal control at all times throughout the organisation;
- (ii) competence;
- (iii) the "tone at the top" i.e. the Management's philosophy and operating style;
- (iv) organisational structure;
- (v) human resource policies and practices.

### **The personal and professional integrity and ethical values of management and staff**

The personal and professional integrity and ethical values of management and staff determine their preferences and tasks judgments, which are translated into standards of behavior. They should exhibit a supportive attitude toward internal controls at all time through out the organinsation.

Every person involve in the organisation both managers and employees has to maintain and demonstrate personal and professional integrity and ethical value and have to comply with the applicable codes of conduct at all times. This can include for example the

disclosure of personal financial interests outside positions and gifts (e.g. by elected officials and senior public servants), and reporting conflicts of interest.

Also public organisations have to maintain and demonstrate integrity and ethical values and they should make those visible to the public in their mission and core values in addition, their operations have to be ethical, orderly, economical, efficient and effective. They have to be consistent with their mission.

### **Competence**

Competence includes the level of knowledge and skill needed to help ensure orderly, ethical, economical, efficient and effective performance as well as a good understanding of individual responsibilities with respect to internal control.

Managers and employees are to maintain a level of competence that allows them to understand the importance of developing, implementing, and maintaining good internal controls and to perform their duties in order to accomplish the general internal control objective and the entity's mission. Everyone in an organisation is involved in internal control with his own specific responsibilities.

Managers and their staff must therefore maintain and demonstrate a level of skill necessary to help ensure effective and efficient performance, and an understanding of internal controls sufficient to effectively discharge their responsibilities.

Providing training for example, can raise the awareness of public servants on internal control and ethical issues, and helps develop public servants' skills to handle ethical dilemmas and understand internal control.

### **Tone at the top**

The tone at the top (i.e. the Management's philosophy and operating style) reflects:

- a supportive attitude toward internal controls at all times, independence, competence and leading by example.
- a code of conduct set out by the management and counseling and performance appraisals that support internal control and ethical behavior.

The attitude established by the Top Management is reflected in all aspects of management's actions. The commitment, the involvement and support of top government officials and legislators in setting "the tone at the top" fosters a positive attitude and are critical in maintaining a positive and supportive attitude towards internal control in an organisation.

If top management believes that internal controls are important, others in the organisation will sense that and will respond by conscientiously observing the controls so established. On the other hand, if the members of the organisation feel that control is not an important concern to the top management and is given lip service rather than meaningful support, it is almost certain that management's control objectives will not be effectively achieved.

Consequently, demonstration and promotion of ethical conduct by the Management is of vital importance to the objective 'ethical operations' in carrying out its role. Management should set a good example through its own actions and its conduct should reflect what is proper rather than what is acceptable or expedient. However, ethics applies to all other objectives. Therefore management policies, procedures and practices should promote orderly, ethical, economical, efficient and effective conduct.

The integrity of managers and their staff is, however, influenced by many elements. Therefore, personnel should periodically be reminded of their obligations under an operative code of conduct issued by the top management. Counseling and performance appraisals are also important. Overall performance appraisals should be based on an assessment of many critical factors including the implementation and maintenance of effective internal controls.

### **Organisational structure**

The organisational structure of an entity provides:

- assignment of authority and responsibility;
- empowerment and accountability; and
- appropriate lines of reporting;

The organisational structure defines the entity's key areas of authority and responsibility. Empowerment and accountability relate to the manner in which this authority and responsibility are delegated throughout the organisation. There can be no empowerment or accountability without a form of reporting. Therefore, appropriate lines of reporting need to be defined. In exceptional circumstances, other lines of reporting have to be possible in addition to the normal ones. Organisational structure is also dealt with in chapter 3 on roles and responsibilities.

### **Human resource policies and practices**

Human resource policies and practices include hiring and staffing, orientation training (formal and on the job) and education evaluating and counseling promoting and compensating and remedial action.

An important aspect of internal control is personnel. Competent, trustworthy personnel are responsible to provide effective control. Therefore, the methods by which persons are hired, evaluated, trained, promoted and compensated are an important part of the control environment. Hiring and staffing decisions should therefore include assurance that individuals have the proper education and experience to carry out their jobs and that the necessary formal, on-the-job, and ethics training is provided. Managers and employees who have a good understanding of internal controls and are willing to take responsibility, are vital to effective internal control.

Human resource management also has an essential role in promoting an ethical environment by developing professionalism and enforcing transparency in daily practice. This becomes visible in recruitment, performance appraisal and promotion processes, which should be based on merits. Securing the openness of selection processes by publishing both the recruitment rules and vacant positions also helps to realise an ethical human resource management.

### **Examples**

We refer the reader to the annexures to this chapter for integrated examples on each of the objectives and the components.

## **Risk Assessment**

Risk assessment is the process of identifying and analysing relevant risks to the achievement of the entity's objectives and determining the appropriate response.

It implies:

(1) Risk identification;

- related on the objectives of the entity;
- comprehensive; and
- include risks due to external and internal factorisation both the entity and the activity levels; and

➤ (2) Risk evaluation:

- estimating the significance of a risk; and
- assessing the likelihood of the risk occurrence

(3) Assessment of the risk appetite of the organisation.

(4) Development of responses:

- four types of responses to risk must be considered: transfer, tolerance, treatment or termination; of these, risk treatment is the most relevant to these guidelines because effective internal controls are the major mechanism to treat risk; and
- the appropriate controls involved can be either detective or preventive.

A Governmental, economic, industry, regulatory and operating conditions are in constant change. Risk assessment should therefore be an ongoing iterative process. It implies identifying and analysing altered conditions and opportunities and risks (risk assessment cycle) and modifying internal controls to address changing risk.

As stressed in the definition, internal controls can provide only reasonable assurance that the objectives of the organisation are being achieved. Risk assessment as a component of internal controls plays a key role in the selection of the appropriate control activities to

undertake. It is the process of identifying and analysing relevant risks to the achievement of the entity's objectives and determining the appropriate response.

Consequently, setting objectives is a precondition to risk assessment. Objectives must be defined before the Management can identify the risks to their achievement and take necessary actions to manage the risks. That means having in place an ongoing process for evaluating and addressing the impact of risks in a cost effective way and having staff with the appropriate skills to identify and assess the potential risks. Internal control activities are a response to risk in that they are designed to contain the uncertainty of outcome that has been identified.

Government entities have to manage the risks that are likely to have an impact on service delivery and the achievement of desired outcomes.

### **Risk identification**

A strategic approach to risk assessment depends on identifying risks against key organisational objectives. Risks relevant to those objectives are then considered and evaluated, resulting in a small number of key risks.

Identifying key risks is not only important in order to identify the most important areas to which resources in risk assessment should be allocated but, also in order to allocate responsibility for management of these risks.

An entity's performance can be at risk due to internal or external factors at both the entity and activity levels. The risk assessment should consider all risks that might occur (including the risk of fraud and corruption). It is, therefore, important that risk identification is comprehensive. Risk identification should be an ongoing, iterative process and is often integrated with the planning process. It is often useful to consider risk from a 'clean sheet of paper' approach, and not merely relate it to the previous review. Such an approach facilitates the identification of changes in the risk profile of an organisation arising from changes in the economic and regulatory environments, internal and external operating conditions and from the introduction of new or modified objective. It is necessary to adopt appropriate tools for the identification of risk. Two of the most

commonly used tools are commissioning a risk review and a risk self-assessment as discussed below:-

### **Commissioning a risk review**

This is a top down procedure. A team is established to consider all the operations and activities of the organisation in relation to its objectives and to identify the associated risks. The team conducts a series of interviews with key members of staff at all levels of the organization to build a risk profile for the whole range of activities thereby identifying the policy fields, activities and functions which may be particularly vulnerable to risk (including the risk of fraud corruption).

### **Risk self assessment**

This is a bottom up approach. Each level and part of the organization is invited to review its activities and feed diagnosis of the risks faced upwards. This may be done through a documentation approach (with a framework).

### **Risk evaluation**

In order to decide how to handle risk, it is essential not only to identify in principle that a certain type of risk exists but to evaluate its significance and assess the likelihood of the risk event occurring. The methodology for analysing risks can vary largely because many risks are difficult to quantify (e.g. reputation risks) while others lend themselves to a numerical diagnosis (particularly financial risks). For the formers a much more subjective view is the only possibility. In this sense, risk evaluation is more of an art than a science.

One of the key purposes of risk evaluation is to inform management about areas of risk where action needs to be taken and their relative priority. Therefore, it will usually be necessary to develop some framework for categorising all risks, for example, as high, medium, or low. Generally, it is better to minimize the categories as over refinement may lead to supervise sprites separation of levels which in reality cannot be separated clearly.

By means of such evaluation, risks can be ranked in order to set management priorities and present information for management decisions about the risks that need to be

addressed (for example, those with a major potential impact and a high likelihood of the risks occurring.)

### **Assessment of the “risk appetite” of the organisation**

An important issue in considering response to risk is the identification of the “risk appetite” of the entity. Risk appetite is the amount of risk to which the entity is prepared to be exposed to before it judges action to be necessary. Decisions about responses to risk have to be taken in conjunction with an identification of the amount of risk that can be tolerated. The risk appetite of an organisation will vary according to the perceived importance of the risks. For example, tolerable financial loss may vary in accordance with a range of features including the size of the relevant budget, the source of the loss or associated other risk such as adverse publicity. Identification of risk appetite is a subjective issue but, it is nevertheless an important stage in formulating the overall risk strategy.

### **Development of responses**

The result of the action outlined above will be a risk profile for the organisation. Having developed a risk profile, the organisation can then consider appropriate responses. Responses to risk can be divided into four categories. In some instances, risk can be transferred, tolerated or terminated.

For some risks, the best response may be to transfer them. This might be done by conventional insurance; by paying a third party to take the risk in another way, or it might be done by contractual stipulations.

The ability to do anything about some risks may be limited, or the cost of taking any action may be disproportionate to the potential benefit gained. In these cases, the response may be to tolerate the risks.

Some risks will only be treatable or containable to acceptable levels, by terminating the activity. In the public sector, the option to terminate activities may be severely limited when compared to the private sector. A number of activities are conducted in the government sector because the associated risks are so great that there is no other way in which the output or outcome, which is required for the public benefit, can be achieved.

However, in most instances, the risk will have to be treated and the entity will need to implement and maintain an effective internal control system to keep risk at an acceptable level. The purpose of treatment is not necessarily to obviate the risk, but more likely to contain it. The procedures that an organisation installs to treat risk are called internal control activities. Risk assessment should play a key role in the selection of appropriate control activities to undertake. Again, it is important to repeat that it is not possible to eliminate all risk and that internal controls can only provide reasonable assurance that the objectives of the organisation are being achieved. However entities that actively identify and manage risks are more likely to be better prepared to respond quickly when things go wrong and to respond to change in general. In designing an internal control system, it is important that the control activity installed is proportionate to the risk. Apart from the extreme undesirable outcome, it is normally sufficient to design a control to give a reasonable assurance of confining loss within the risk appetite of the organisation. Every control has an associated cost and the control activity must offer value for its cost in relation to the risk that it is addressing.

Because governmental, economic, industry, regulatory and operating conditions continually change, the risk environment of any organization is constantly changing, and priorities of objectives and the consequent importance of risks will shift and change. Fundamental to risk assessment is an ongoing iterative process to identify changed conditions and take actions as necessary. Risk models and related controls have to be regularly revisited and reconsidered in order to have assurance that the risk profile continues to be valid. that responses to risk remain appropriately targeted and proportionate, and mitigating controls remain effective as risks change over time

### **Examples**

We refer the reader to the annexures to this chapter for integrated examples on each of the objectives and the components.

### **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 integrated with the overall organisational objectives. Control activities occur throughout the organisation, at all levels and in all functions. They include a range of detective and preventive control activities as diverse.

for example, as:

- (1) authorization and approval procedures;
- (2) segregation of duties (authorizing, processing, recording, reviewing);
- (3) controls over access to resources and records;
- (4) verifications;
- (5) reconciliations;
- (6) reviews of operating performance;
- (7) reviews of operations, processes and activities; and
- (8) supervision (assigning, reviewing and approving guidance and training )

Control activities (1) -(3) are preventive, (4)- (6) are more detective while (7) and (8) are both preventive and detective. Entities should reach an adequate balance between enforcement and prevention control activity.

Control activities are the policies and procedures established and executed to address risks and to achieve the entity's objectives. To be effective, control activities need to:

- be appropriate (that is the right control in the right place and commensurate to the risk involved).
- function consistently according to plan throughout the period(that is be complied with carefully by all employees involved and not bypassed when key personnel are away or the workload is heavy).
- be cost effective(that is, the cost of implementing the control should not exceed the benefits derived); and

- be comprehensive, reasonable and integrated into the overall organisational objectives.

Control activities include a range of policies and procedures as diverse as;

### **1. Authorization and approval procedures**

Authorizing and executing transactions and events are only done by persons acting within the scope of their authority. Authorization is the principal means of ensuring that only valid transactions and events are initiated as intended by the Management. Authorization procedures which should be documented and clearly communicated to managers and employees should include the specific conditions and terms under which authorisations are to be made. Conforming to the terms of authorization means that employees act in accordance with directives and within the limitations established by management or legislation.

### **2. Segregation of duties (authorizing, processing, recording, reviewing)**

To reduce the risk of error, waste, or wrongful acts and the risk of not detecting such problems, no single individual or section should control all key stages of a transaction or event. Rather, duties and responsibilities should be assigned systematically to a number of individuals to ensure that effective checks and balances exist. Key duties include authorizing and recording transactions, processing, and reviewing or auditing transactions. Collusion, however, can reduce or destroy the effectiveness of this internal control technique. A small organisation may have too few employees to fully implement this technique. In such cases, the management must be aware of the risks and compensate with other controls. Rotation of employees may help ensure that one person does not deal with all the key aspects of transactions or events for an undue length of time. Also, encouraging or requiring annual holidays may help reduce risk by bringing about a temporary rotation of duties.

### **3. Controls over access to resources and records**

Access to resources and records is limited to authorised individuals who are accountable for the custody and/or use of resources. Restricting access to resources reduces the risk of unauthorised use or loss to the government and helps achieve management directives.

The degree of restriction depends on the vulnerability of the resource and the perceived risk of loss or improper use, and should be periodically assessed. When determining an asset's vulnerability, its cost, portability and exchangeability should be considered.

#### **4. Verification**

Transactions and significant events are verified before and after processing e.g. when goods are delivered, the number of goods supplied is verified with the number of goods ordered. Afterwards, the number of goods invoiced is verified with the number of goods received. The inventory is verified as well by performing stock-taking.

#### **5. Reconciliations**

Records are reconciled with the appropriate documents on a regular basis, e.g. the accounting records relating to bank accounts are reconciled with the corresponding bank statements.

#### **6. Reviews of operating performance**

Operating performances are reviewed against a set of standards on a regular basis, assessing effectiveness and efficiency.

#### **7. Reviews of operations, processes and activities**

Operations should be reviewed. This type of review of the actual operations of an organisation should be clearly distinguished from the monitoring of internal control which is discussed separately in Section 2.5.

#### **8. Supervision (assigning, reviewing and approving, guidance and training)**

Competent supervision ensures that internal control objectives are achieved. Assignment, review, and approval of an employee's work encompasses;

- clearly communicating the duties, responsibilities, and accountabilities assigned to each staff member;
- systematically reviewing each member's work to the extent necessary; and
- approving work at critical points to ensure that it flows as intended.

A supervisor's delegation of work should not diminish the supervisor's accountability for these responsibilities and duties. Supervisors also provide their employees with the necessary guidance and training to help ensure that errors, waste, and wrongful acts are minimized and that management directives are understood and achieved.

The above mentioned list is not exhaustive but enumerates the most common preventive and detective control activities. Control activities 1-3 are preventive, 4-6 are more detective while 7-8 are both preventive and detective. Entities should reach an adequate balance between enforcement and prevention control activities, where by often a mix of controls is used to compensate for the particular disadvantages of individual controls. Once a control activity is implemented, it is essential that assurance about its effectiveness is obtained. Moreover, it must be clear that control activities form only a component of internal controls. They should be integrated with the other four components of internal control.

### **Examples**

We refer the reader to the annexures to this chapter for integrated examples on each of the objectives and the components.

### **Information Technology Control Activities**

Information system implies specific type of control activities. Therefore, information technology controls consist of two broad groupings:

#### **(1) General Controls**

General controls are the structures, policies and procedures that apply to all or a large segment of an entity's information system and help ensure their proper operation. They create the environment in which application systems and controls operate.

Major categories of general controls are (1) entity-wide security program planning and management; (2) Access controls; (3) Controls on the development maintenance and change of the application software; (4) System controls; (5) Segregation of duties; and (6) service continuity.

## **(2) Application Control**

Application controls are the structures, policies and procedures that apply to separate individual application systems and computerized applications. These controls are generally designed to prevent, detect and correct errors and irregularities as information flows through information systems. General and application controls are interrelated and both are needed to ensure complete and accurate information processing. Because information technology changes rapidly, the associated controls must evolve constantly to remain effective.

As information technology has advanced, organisations have become increasingly dependent on computerized information systems to carry out their operations and to process, maintain, and report essential information. As a result, the reliability and security of computerised data and of the systems that process, maintain, and report these data are a major concern to the management and auditors of organisations.

The use of automated systems to process information introduces several risks that need to be considered by the organisation. These risks stem from, among other things, uniform processing of transactions: information systems automatically initiating transactions; increased potential for undetected errors; existence, completeness, and volume of audit trails; the nature of hardware and software used; and recording of unusual or non-routine transactions. For example, an inherent risk from the uniform processing of transactions is that any error arising from computer programming problems will occur consistently in similar transactions. Effective information technology controls can provide management with reasonable assurance that information processed by its systems meets desired control objectives, such as ensuring the completeness, timeliness, and validity of data and preserving its integrity.

Information technology controls consist of two broad groupings, general controls and application controls.

### **General controls**

General controls are the structure, policies and procedures that apply to all or a large segment of an entity's information system such as mainframe, minicomputer, network,

and end-user environments and help ensure their proper operation. They create the environment in which application systems and controls operate.

**The major categories of general controls are:**

1. Entity wide security program planning and management provide a framework and continuing cycle of activity for managing risk, developing security policies, assigning responsibilities, and monitoring the adequacy of the entity's computer related controls.
2. Access controls limit or detect access to computer resources (data, programs, equipment and facilities), thereby protecting these resources against unauthorized modification, loss, and disclosure. Access controls include both physical and logical controls.
3. Controls on the development, maintenance and change of application software prevent unauthorized programs or modifications to existing programs.
4. System software controls limit and monitor access to the powerful programs and sensitive files that control the computer hardware and secure applications supported by the system.
5. Segregation of duties implies that policies, procedures and an organisational structure are established to prevent one individual from controlling key aspects of computer-related operations and there by conducting unauthorised actions or gaining unauthorised access to assets or records.
6. Service continuity controls ensure that when unexpected events occur, critical operations continue without interruption or are promptly resumed and critical and sensitive data are protected.

**Application controls**

Application controls are the structure, policies, and procedures that apply to separate individual application systems-such as accounts payable, inventory, payroll, grants, or loans-and are designed to cover the processing of data within specific application software. These controls are generally designed to prevent, detect, and correct errors and irregularities as information flows through information systems. Application controls and

the manner in which information flows through information systems can be categorised into three phases of a processing cycle.

**Inputs:** data are authorized, converted to an automated form and entered into the application in an accurate complete and timely manner;

**processing:** data are properly processed by the computer and files are updated correctly; and

**output:** files and reports generated by the application reflect transactions or events that actually occurred and accurately reflect the results of processing, and reports are controlled and distributed to the authorized users.

Application controls may also be categorized by the kind of control objectives they relate to, including whether transactions and information are authorized, complete, accurate and valid. Authorization controls concern the validity of transactions and help ensure transactions represent events that actually occurred during a given period. Completeness controls relate to whether all valid transaction are recorded and properly classified. Accuracy controls address whether transactions are recorded correctly and all the data elements are accurate. Controls over the integrity of processing and data files if deficient could nullify each of the above mentioned application controls and allow the occurrence of unauthorized transaction as well as contribute to incomplete and inaccurate data.

Application controls include programmed control techniques, such as automated edits, and manual follow-up of computer-generated output such as reviews of reports identifying rejected or unusual items.

### **General and application controls over computer systems are interrelated**

The effectiveness of general controls is a significant factor in determining the effectiveness of application controls. If general controls are weak, they severely diminish the reliability of controls associated with individual applications. Without effective general controls, application controls may be rendered ineffective by override, circumvention or modification. For example, edit checks designed to prevent users from entering unreasonably large amounts of money in a payment processing system can be an effective application control. However this control can not be relied on if the general

controls permit unauthorized program modification that might allow some payments to be exempt from the edit. While the basic objectives of control do not change, rapid changes in information technology require that controls evolve to remain effective. Changes such as the increased reliance on networking, powerful computers that place responsibility for data processing in the hands of end users, Electronic commerce and the internet will affect the nature and implementation of specific control activities.

### **Example**

We refer the reader to the annexures to this chapter for integrated examples on each of the objectives and the components.

### **Information and Communication**

Information and communication are essential to the realisation of all the internal control objectives.

#### **Information**

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 time frame that enables staff to carry out their internal control and responsibilities (timely communication to the right people) Therefore, the internal control system and all transactions and significant events should be fully documented. Information systems produce reports that contain operations, 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 conditions necessary to enable decision-making and reporting.

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

Information and communication are essential to the realisation of all the internal control objectives. For example, one of the objectives of internal control is fulfilling public

accountability obligations. This can be achieved by developing and maintaining reliable and relevant financial and non-financial information and communicating this information by means of a fair disclosure in timely reports. Information and communication relating to the organisation's performance will create the possibility to evaluate the orderliness, ethicality, economy, efficiency and effectiveness of operations. In many cases, certain information or communications have to be provided in order to comply with laws and regulations. Information is needed at all levels of an organisation in order to have effective internal control and achieve the entity's objectives. Therefore, an array of pertinent, reliable and relevant information should be identified, captured and communicated in a form and timeframe that enables people to carry out their internal control and other responsibilities. A precondition for reliable and relevant information is the prompt recording and proper classification of transactions and events.

Transactions and events must be recorded promptly when they occur if information is to remain relevant and valuable to the management in controlling operations and making decisions. This applies to the entire process or life cycle of a transaction or event including the initiation and authorization, all stages while in process, and its final classification in summary records. It also applies to promptly updating all documentation to keep it relevant. Proper classification of transactions and events is also required to ensure that reliable information is available to management. This means organizing, categorizing, and formatting information from which reports, schedules, and financial statements are prepared. 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. The systems deal not only with quantitative and qualitative forms of internally-generated data, but also with information about external events, activities and conditions necessary for informed decision making and reporting. Management's ability to make appropriate decisions is affected by the quality of information, which implies that the information is:

- appropriate (Is the needed information there?)
- timely (Is it there when required?)
- current( Is it the latest available):

- accurate (Is it correct?)
- accessible (Can it be obtained easily by the relevant parties?)

In order to ensure the quality of information and reporting, to carry out the internal control activities and responsibilities and to make monitoring more effective and efficient, the internal control system and all transactions and significant events should be fully and clearly documented (e.g. flow charts and narratives ). This documentation should be readily available for examination. Documentation of the internal control system should include identification of an organization's structure and policies and its operating categories and related objectives and control procedures. An organization must give written evidence of the components of the internal control process, including its objectives and control procedures. The extent of the documentation of an entity's internal control varies however with the entity's size, complexity and similar factors.

### **Communication**

Effective communication should flow down, across and up the organisation, throughout all components and the 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.

Information is a basis for communication, which must meet the expectations of groups and individuals, enabling them to carry out their responsibilities effectively. Effective communication should occur in all directions, flowing down, across and up the organization throughout all components and the entire structure. One of the most critical communication channels is that between the management and its staff. Management must be kept up to date on performance, developments, risks and the function of internal control and other relevant events and issues. By the same token, the management should communicate to its staff what information it needs and provide feedback and direction. Management should also provide specific and directed communication addressing

behavioral expectations. This includes a clear statement of the entity's internal control, philosophy and approach and delegation of authority. Communication should raise awareness about the importance and relevance of effective internal control communicate the entity's risk appetite and risk tolerances, and make personnel aware of their roles and responsibilities in effecting and supporting the components of internal control.

In addition to internal communications, management should ensure there are adequate means of communicating with, and obtaining information from external parties, as external communications can provide input that may have a highly significant impact on the organisation achieving its goals.

### **Examples**

We refer the reader to the annexes for integrated examples on each of the objectives and the components.

### **Monitoring**

Internal control systems should be monitored to assess the quality of the system's performance over time. Monitoring is accomplished through routine activities, separate evaluations or a combination of both.

#### **(1) Ongoing monitoring**

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. Ongoing monitoring activities cover each of the internal control components and involve action against irregular, unethical, uneconomical, inefficient and ineffective internal control systems.

#### **(2) Separate evaluations**

The scope and frequency of separate evaluations will depend primarily on an 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.

Monitoring internal control ensures that controls are operating as intended and that they are modified appropriately for changes in conditions. This is accomplished through ongoing monitoring activities, separate evaluations or a combination of both, in order to ensure that internal control continues to be applied at all levels and across the entity, and that internal control achieves the desired results. Monitoring the internal control activities themselves should be clearly distinguished from monitoring an organisation's operations as an internal control activity. That type of monitoring has been discussed in 2.3

Ongoing monitoring occurs in the course of normal, recurring operations of an organisation. It is performed continually and on a real-time basis, it reacts dynamically to changing conditions and is ingrained in the entity's operations. As a result it is more effective than separate evaluations. Since separate evaluations take place after the fact, problems will often be identified more quickly by ongoing monitoring routines.

The scope and frequency of separate evaluations should depend primarily on the assessment of risks and the effectiveness of ongoing monitoring procedures. When making that determination, the organisation should consider the nature and degree of changes, from both internal and external events, and their associated risks; the competence and experience of the personnel implementing risk responses and related controls; and the results of the ongoing monitoring. Separate evaluations of control can also be useful by focusing directly on the controls' effectiveness at a specific time. Separate evaluations may take the form of self-assessments as well as a review of control design and direct testing of internal control. Separate evaluations also may be performed by the SAI's or by external auditors.

Usually, some combination of ongoing monitoring and separate evaluations will ensure that internal control maintains its effectiveness over time.

All deficiencies found during ongoing monitoring or through separate evaluations should be communicated to those positioned to take necessary action. The term "deficiency" refers to a condition that affects an entity's ability to achieve its general objectives. Deficiency, therefore, may represent a perceived, potential or real shortcoming or an opportunity to strengthen internal control to increase the likelihood that the entity's general objectives will be achieved.

Providing needed information on internal control deficiencies to the right party is critical. Protocols should be established to identify what information is needed at a particular level for effective decision making. Such protocols reflect the general rule that a manager should receive information that affects actions or behavior of personnel under his or her responsibility as well as information needed to achieve specific objectives.

Information generated in the course of operations is usually reported through normal channels, which means to the individual responsible for the function and also to at least one level of management above that individual. However, alternative communication channels should also exist for reporting sensitive information such as illegal or improper acts.

Monitoring internal control should include policies and procedures that ensure that the findings of audits and other reviews are adequately and promptly resolved. Managers are to (1) promptly evaluate findings from audits and other reviews, including those showing deficiencies and recommendations reported by auditors and others who evaluate agency operations, (2) determine proper actions in response to findings and recommendations from audits and reviews and (3) complete within established time frames, all actions that correct or otherwise resolve the matters brought to their attention.

The resolution process begins when audit or other review results are reported to management and is only completed after action has been taken that (1) corrects the identified deficiencies, (2) produces improvements, or (3) demonstrates that the findings and recommendations do not warrant management action.

## **Examples**

We refer the reader to the annexes for integrated examples on each of the objectives and the components.

### **6.03 Roles and Responsibilities**

Everyone in an organisation has some responsibility for internal control:

**Managers** - are directly responsible for all activities of an organisation including the internal control system. Their responsibilities vary depending on their function in the organisation (e.g. board, financial officer, audit committee) and the organisation's characteristics.

**Internal auditors** - examine the effectiveness of internal control and recommend improvements, but they don't have primary responsibility for establishing or maintaining it.

**Staff members** - contribute to internal control as well. Internal control is an explicit or implicit part of everyone's duties. All staff members play a role in effecting control and should be responsible for reporting problems of operations, non-compliance with the code of conduct, or violations of policy.

External parties also play an important role in the internal control process. They may contribute to achieving the organisation's objectives, or may provide information useful to effect internal control. However, they are not responsible for the establishment or operations of the organisation's internal control system.

**Supreme Audit Institutions (SAI's)** - encourage and support the establishment of effective internal control in the government. The assessment of internal control is essential to the SAI's compliance, financial and performance audits. They communicate their findings and recommendations to interested stakeholders.

**External auditors** - audit of certain Government organisations in some countries. They and their professional bodies should provide advice and recommendations on internal control.

**Legislators and regulators** - establish rules and directives regarding internal control.

They should contribute to a common understanding of internal control.

**Other parties** - interact with the organisations (beneficiaries, suppliers, etc) and provide information regarding achievement of its objectives.

Internal control is primarily affected by an entity's internal stakeholders including management, internal auditors and other staff. However the actions of external stakeholders also impact the internal control system.

All personnel in the organisation play important roles in making internal control work. However, management has the overall responsibility for the design, implementation and proper functioning of the internal control system. The management organization structure may include boards and audit committees, which all have different roles and compositions and are subject to different legislation in different countries.

Management often establishes an internal audit unit as part of the internal control system and uses it to help monitor the effectiveness of internal control. Although internal auditors can be a valuable educational and advisory resource on internal control, the internal auditor should not be a substitute for a strong internal control system.

For an internal audit function to be effective, it is essential that the internal audit staff be independent from management, work in an unbiased, correct and honest way and that they report directly to a high level of authority within the organisation. This allows the internal auditors to present unbiased opinions on their assessments of internal control and objectively present proposals aimed at correcting the revealed shortcomings

For professional guidance, internal auditors can look to the Institute of Internal Auditors (IIA) and the INTOSAI code of ethics.

In addition to its role of monitoring and entity's internal controls and adequate internal audit staff can contribute to the efficiency of the external audit efforts by providing direct assistance to the external auditor. The nature, scope or timing of the external auditor's procedures may be modified if the external auditor can rely upon the internal auditor's work.

Staff members and other personnel also effect internal control. It is often these

frontline individuals who apply controls, review controls, correct misapplied controls, and identify problems that may best be addressed through controls in conducting their daily assignments.

The second major group of internal control stakeholders is external parties such as external auditors (including SAI's) legislators and regulators, and other parties. They may contribute to achieving the organisation's objectives or may provide information useful to effect internal control. However they are not responsible for the establishment or operation of the organisation's internal control system.

The tasks of external parties in particular external auditors and SAI's include assessing the functioning of the internal control system and informing management about its findings. SAI's may play a strategic role in the development of the internal control system, directly and indirectly, depending on their legal mandate and the management structure of the organisation

Auditors' assessing of internal control procedures implies:

- determining the significance and the sensitivity of the risk for which controls are being assessed;
- assessing the susceptibility to misuse of resources, failure to attain objectives regarding ethics, economy, efficiency and effectively or failure to fulfill accountability obligators and non compliance with laws and regulation;
- identifying and understanding the relevant internal controls;
- determining what is already known about control effectiveness;
- assessing the adequacy of the control design;
- determining, through testing. if controls are effective reporting on the internal control assessments and discussing the necessary corrective actions.

The SAI also has a vested interest in ensuring that strong internal audit units exist where needed. Those audit units constitute an important element of internal control by providing a continuous means for improving an organisation's operations. In some countries, however, the internal audit units may lack independence, be weak, or be non-existent. In

those cases the SAI should, whenever possible, offer assistance and guidance to establish and develop those capacities and to ensure the independence of the internal auditor's activities. This assistance might include secondment or lending of staff, conducting lectures, sharing training materials, and developing methodologies and work programs.

The Supreme Audit Institution also needs to develop a good working relationship with the internal audit units so that experience and knowledge can be shared and work mutually can be supplemented and complemented. Including internal audit observations and recognizing their contributions in the external audit report when appropriate can also foster this relationship. The SAI should develop procedures for assessing the internal audit unit's work to determine to which extent it can be relied upon. A strong internal audit unit could reduce the audit work of the SAI and avoid needless duplication of work. The SAI should ensure that it has access to internal audit reports, related working papers, and audit resolution information.

Legislation can provide a common understanding of the internal control definition and objectives to be achieved. It can also prescribe the policies that internal and external stakeholders are to follow in carrying out their respective roles and responsibilities for internal control.

### Annexure -1 Examples

#### **(A) Fulfilling accountability obligations**

##### **Example(1):**

A department that is responsible for the management of safe transport by water and sea has been organized by different service departments responsible for piloting, buoy age inspection of the quality of the water, promotion of the use of waterways, investments in and maintenance of infrastructure (bridges, dikes, canals and docks)

<b>Control Environment</b>	<b>Risk Assessment</b>	<b>Control Activities</b>	<b>Information &amp; Communication</b>	<b>Monitoring</b>
For each of the service departments an operational manager is appointed who has to report to the general manager of the department. The operational managers have the appropriate skills and have the authority to make certain decisions. All of them also sign a code of proper conduct.	Possible risk is collisions of ships, draining off toxic waste or fuel and bursting of dikes In case this is related to negligence of the government department it could face a huge liability.	Control activities that can be organised are the pilot age of ships by competent pilots, placing buoyed, beacons and markers; visual inspection by air and taking water samples.	The information and communication related to this situations can be the reporting of collisions is to want other ships; informing ships of weather conditions and publishing the names of polluters and the sanctions they are facing and the remedial actions under taken	A follow-up of the number of collisions, environmental violations, results of the samples and a comparison with other countries and with historical data can help to monitor the effectiveness and efficiency of the pilotage of ships the placing of the beacons and makers, the inspections, and the water samples

##### **Example (2):**

The manager of the department of sports stipulated last year the objective that the practice of sports would increase by 15% in the coming years.

<b>Control Environment</b>	<b>Risk Assessment</b>	<b>Control Activities</b>	<b>Information &amp; Communication</b>	<b>Monitoring</b>
Because of the manager's good reputation, the executive committee trusted the manager and did not carry out the usual status meetings to check on the manager's progress.	By not specifying the objectives, the risk arises of not achieving them. Also the danger exists that reporting will not be timely as the manager wants to wait with this report until he can say he realized the objective of 15% growth. Moreover how to measure the 15% growth was not revealed so he can say the number of people doing sports has increased or the number of hours people doing sports, or even the number of sports centers or sports clubs has increased by 15% This way the quality of the reported information decreases substantially.	This risk can be decreased by installing appropriate lines of reporting and a reporting model which defines the information that should be given.	The report should be delivered in time and according to the specified reporting model. It should specify the growth objective, how they are measured and why they are measured this way All the back up information should be available.	The verification of whether or not the report is satisfactory and what information is given and what information is still missing can be a form of monitoring.

**(B) Compliance with applicable laws and regulations**

**Example:**

The ministry of defence wants to buy new fighter planes via a public contract and publishes all stipulations and procedures for this government tender. All tenders received are left unopened until the end of the tender period. At that moment, all tenders are opened in the presence of the responsible managers and some officials. Only these tenders will be investigated and compared to decide which tender is the best.

<b>Control Environment</b>	<b>Risk Assessment</b>	<b>Control Activities</b>	<b>Information &amp; Communication</b>	<b>Monitoring</b>
The team that will	One of the risks	In order to	The procedures relating	Internal audit can

<p>execute this transaction is composed of competent people who signed a document that they have no financial or relational bond with any of the tenderers. The responsible managers and officials also signed this document.</p>	<p>related to Government tenders and public contract is insider dealing. One of the tenderers may have prior knowledge of the bids of the other tenderers and could make a winning tender with this information resulting in what may not be the best choice of all tenders. Another risk consists of choosing the wrong tender which may result in a new public contract because the other one did not meet the expectations. Also claims are possible of other tenderers who feel they were unfairly treated.</p>	<p>treat mitigate risks procedures should be developed and applied in accordance with all relevant laws and regulations concerning public contracts.</p>	<p>to the publication of all stipulations for this Government tender, the assessment of the received tenders and the announcement of the selected tenderer, should be documented in writing and detail all actions to be taken. When assessing the tenders, all remarks and reasons why a tender was or was not chosen should be documented.</p>	<p>do file-reviews and follow-ups of claims.</p>
---	---	--	--	--

**(C) Orderly, ethical, economical, efficient and effective operations Example (1):**

The department of culture wants to increase museum visits by the public. In order to accomplish this, it proposes to build new museums, give every citizen a cultural cheque and decrease ticket prices. To be economical, effective and efficient, management has to

consider and evaluate whether or not the objectives as formulated can be achieved by its proposals and how much each of these proposals will cost.

<b>Control Environment</b>	<b>Risk Assessment</b>	<b>Control Activities</b>	<b>Information &amp; Communication</b>	<b>Monitoring</b>
The department of culture needs to make sure that its organization structure is suited to support overseeing design and construction of the proposed additions, as well as planning and operations of the new museums.	The fact that the number of museum visits does not increase is one of the possible risks. Also the risk that some of the proposal will back fire and exceed their budget possible for instance decreasing ticket prices without having a positive effect on museum visits decreases the Government receipts, and building new museums without proper planning and consideration of requirements of light, temperature and security can cause a number of expensive adjustments that have to be made afterwards.	The control activities related to the before mentioned risk can be a budgetary control that compares actual to budget observations of the progress of the construction, and demanding justifications for overspending the budget.	The information and communication related to this example can consist of the documentation of meetings with architects fire department (for safety regulations), artists and others. It can also contain different reports concerning following up on the budget and the progress of the progress of the construction work.	The analysis of the justifications for exceeding budget and related interest costs due to delayed work or payments are a part of monitoring.

**Example(2):**

The Government wants to develop agriculture and increase the quality of life at the countryside. They provide funds to subsidize the construction of irrigation and the drilling of wells.

<b>Control</b>	<b>Risk</b>	<b>Control</b>	<b>Information &amp;</b>	<b>Monitoring</b>
----------------	-------------	----------------	--------------------------	-------------------

<b>Environment</b>	<b>Assessment</b>	<b>Activities</b>	<b>Communication</b>	
The Government must ensure that it has the appropriate department in place to implement and conduct the subsidy operation and create the appropriate tone for the timely and efficient completion of this project.	The risks involved are that unscrupulous associations qualify for a grant but do not use the money for that at was intended.	Control activities can be checking the qualifications of the associations employing for a grant checking on site the progress of and reviewing progress reports of the construction works Checking the expenditures of the associations by reviewing their invoices, and delaying payment of (or part of) the subsidy until this review is completed.	<ul style="list-style-type: none"> <li>▪ Progress reports detailing the costs and the number of wells that were drilled and the number of acres that were irrigated.</li> <li>▪ (Copies of) invoices are requested as justification for the subsidized expenses.</li> </ul>	Monitoring can consist of a follow-up of the drilling of wells and the construction of irrigation, and a comparison with other similar projects. Also a follow-up on the proceeds of the irrigated land can be considered.

**(D) Safeguarding resources**

**Example (1):**

The Ministry of Defence has some warehouses, military stores and fuel depots. The army command has the policy that these supplies are only for professional military use and not for personal use.

<b>Control Environment</b>	<b>Risk Assessment</b>	<b>Control Activities</b>	<b>Information &amp; Communication</b>	<b>Monitoring</b>
Good human capital policies would be effective in recruiting and	The risk exists that people will want to try to steal weapons to use them	Control activities that deal with these risks can be putting fences	Reports of damaged fences and differences noticed during stock takes. Supply	Monitoring can be an inspection of the fence, unannounced

maintaining the appropriate personnel to staff and operated such warehouses.	inappropriately or sell them. Also other supplies like fuel can be vulnerable to theft.	and walls around the warehouses and depots. You can also put armed guards with dogs at the entrances. Regularly checking the stock records and a procedure which states that supplies can only be given with approval of a superior officer will also help to safeguard the assets.	approvals and procedures also provide information and communication related to this objective.	stock takes, follow-up of stock movements or even a secret test of security.
--	---	---	--	--

**Example (2):**

Large amounts of sensitive information are stored on computer media in an agency of the ministry of justice. However, the importance of IT controls is neglected and consequently the IT control has numerous deficiencies.

<b>Control Environment</b>	<b>Risk Assessment</b>	<b>Control Activities</b>	<b>Information &amp; Communication</b>	<b>Monitoring</b>
Management must dedicate its commitment to competence and proper behaviour involving IT, and provide proper training in this area. Human capital policies also play a key role in establishing a positive control environment for	At the general controls level, the agency has not: <ul style="list-style-type: none"> <li>• limited user access to only that needed by users to perform their duties;</li> <li>• developed adequate system software controls to protect programs and sensitive data;</li> <li>• documented software changes;</li> </ul>	The agency can: <ul style="list-style-type: none"> <li>• implement logical (e.g. passwords) and physical access controls (e.g. locks, Id badges, alarms).</li> <li>• deny the ability to log in to the operating system for application users.</li> </ul>	Procedures on IT control should be available and software changes should be documented before the software is placed in operation. Policies and job descriptions supporting the principles of segregation of duties should be developed. Audit	Performing and IT audit, doing a disaster simulation exercise, monitor the web server activity, can be part of the monitoring of the IT environment.

<p>IT issues.</p>	<ul style="list-style-type: none"> <li>• segregated incompatible duties;</li> <li>• addressed service continuity;</li> <li>• protected its network from unauthorized traffic.</li> </ul> <p>At the application controls level, the agency has not maintained access authorizations.</p>	<ul style="list-style-type: none"> <li>• limit access to the production environment for the application development staff.</li> <li>• use audit logs to register all access (attempts) and commands to detect security violations.</li> <li>• have a contingency and disaster recovery plan to ensure the availability of critical resources and facilitate the continuity of operations</li> <li>• have firewalls and monitor the web server activity to secure the network traffic.</li> </ul>	<p>logs on access (attempts) and (unauthorized) commands should be periodically reported and reviewed.</p>	
-------------------	---	--	--	--

## **Annexure-2**

### **Glossary**

This glossary is intended to provide a common understanding of the main terms used in these guidelines in respect to internal control definitions and practices. In addition to some definitions we introduced in this document, we also used existing definitions from various sources as noted.

- Code of ethics and auditing standards. INTOSAI, 2001. (INTOSAI auditing standards).
  - Internal Control- Integrated Framework, COSO. 1992.. (COSO 1992)
  - Glossarium. Office for official publications of the European communities. P. Everard and D. Wolter 1989, (glossarium)
  - Auditing and assurance services an integrated approach. A.A. Arens. R.J.Elder and M.S. Beasley. Prentice Hall international edition, ninth edition, 2003. (Arens. Elder& Beasley)
  - the COSO exposure draft "Enterprise Risk Management Framework", COSO, 2003 (COSO ERM)
  - Handbook of international auditing, assurance, and ethics pronouncements, IFAC,2003. (IFAC)
  - (Transparency International, 1996)
  - (XVI INTOSAI, Uruguay, 1998)
- (A)

#### **Access control**

In information technology, controls designed to protect resources from unauthorized modification, loss or disclosure.

#### **Accountability**

-The process whereby public service bodies and the individuals within them are held responsible for their decisions and actions, including their stewardship of public funds and all aspects of performance.

-Duty imposed on an audited person or entity to show that he/ it has administered or controlled the funds entrusted to him/it in accordance with the terms on which the funds were provided. (glossarium)

### **Application**

Computer program designed to help people perform a certain type of work, including specific functions such as payroll, inventory control, accounting, and mission support. Depending on the work for which it is designed and application can manipulate text, numbers, graphics, or a combination of these elements.

### **Application Controls**

-The structure policies, and procedures that apply to separate individual application systems and they are designed to cover the processing of data within specific applications software.

-Programmed procedures in application software and related manual procedures, designed to help ensure the completeness and accuracy of information processing .Examples include computerized edit checks of input data, numerical sequence checks and manual procedures to follow up on items listed in exception reports. (COSO 1992)

### **Audit**

-Review of a body's activities and operations to ensure that these are being performed or are functioning in accordance with objectives, budget, rules and standards. The aim of this review is to identify, at regular intervals, deviations which might require corrective action. (glossarium)The accumulation and evaluation of evidence about information to determine and report on the degree of correspondence between the information and established criteria. ( Arens, Elder & Beasley)

-The objective of an audit of financial statement is to enable the auditors to express an opinion whether the financial statements are prepared, in all materials respects, in accordance with an identified financial reporting framework .The phrases used to express the auditor's opinion are "give a true and fair view" present fairly, in all material

respects," which are equivalent terms. A similar objective applies to the audit of financial or other information prepared in accordance with appropriate criteria. (IFAC)

### **Audit Committee**

A committee of the Board of Directors whose role typically focuses on aspects of financial reporting and on the entity's processes to manage business and financial risk, and for compliance with significant applicable legal, ethical and regulatory requirements. The Audit Committee typically assists the Board with the oversight of (a) the integrity of the entity's financial statements. (b) the entity's compliance with legal and regulatory requirements, the independent auditor's qualifications and independence, (d) the performance of the entity's internal audit function and that of the independent audit ors and (e) compensation of company executives.

### **Audit Institution**

Public body which however it is appointed, composed or organised carries out external audit duties in accordance with the law (glossarium)

## **B**

### **Budget**

Quantitative, financial expression of a program of measures planned or a given period. The budget is drawn up with a view to planning future operations and to making ex post facto checks on the results obtained. (glossarium)

### **Budgetary control**

Control by which an authority which has granted an entity a budget ensures that this budget has been implemented in accordance with the estimates, authorisations and regulations. (glossarium)

## **C**

### **Collusion**

A cooperative effort among employees to defraud a business of cash, inventory, or other assets. (Arens, Elder & Beasley).

## **Compliance**

Having to do with conforming with laws and regulations applicable to an entity. (COSO 1992)

## **Component**

One of five elements of internal control. The internal control components are the entity's internal control environment, risk assessment, control activities, information and communication, and monitoring.(COSO 1992)

## **Computer Controls**

1. Controls performed by computer, i.e., controls programmed into computer software (contrast with manual controls). 2. Controls over computer processing of information, consisting of general controls and application controls (both programmed and manual). (COSO 1992)

## **Computer Information Systems**

A computer information system (CIS) environment exists when a computer of any type or size is involved in the processing by the entity of financial information of significance to the audit, whether that computer is operated by the entity or by a third party. (IFAC)

## **Control**

1. a noun, used as a subject, e.g., existence of a control- a policy or procedure that is part of internal control. A control can exist within any of the five components. 2. A noun, used as an object, e.g., to effect control- the result of policies and procedures designed to control; this result may or may not be effective internal control. 3. A verb, e.g., to control- to regulate; to establish or implement a policy that affects control. (COSO 1992)

## **Control activity**

Control activities are the policies and procedures established to address risks and to achieve the entity's objectives. The procedures that an organisation puts in place to treat risk are called internal control activities. Internal control activities are a response to risk in that they are designed to contain the uncertainty of outcome that has been identified.

## **Control Environment**

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

## **Corruption**

Corruption involves behavior on the part of officials in the public sector, whether politicians or civil servants, in which they improperly and unlawfully enrich themselves, or those close to them, by the misuse of the public power entrusted to them' (Transparency International, 1996).

## **COSO**

Committee of Sponsoring Organisations of the Tread way Commission, a group of several accounting organisations. They published in 1992, a significant study on internal control titled

Internal Control- Integrated Framework. The study is often referred to as the COSO Report.

## **D**

### **Data**

Facts and information that can be communicated and manipulated.

### **Deficiency**

A perceived, potential or real internal control shortcoming or an opportunity to strengthen control to provide a greater likelihood that the entity's objectives are achieved. (COSO 1992).

### **Design**

1. Intent. As used in the definition, internal control is intended to provide reasonable assurance as to the achievement of objectives; when the intent is realized, the system can be deemed effective.

2. Plan the way a system is supposed to work, contrasted with how it actually works.  
(COSO 1992)

### **Detective Control**

A control designed to discover an unintended event or result (contrast with preventive control) (COSO 1992)

### **Documentation**

- Documentation of the internal control structure should include Identification of an organization's structure and policies and its operating categories and related objectives and control procedures. These should appear in documents such as management directives, administrative policies, procedures manuals, and accounting manuals.
- Documentation is the material (working papers) prepared by and for, or obtained and retained by the auditor in connection with the performance of the audit. (IFAC)
- The auditor's examination of the client's documents and records to substantiate the information that is or should be included in the financial statements. (Arens. Elder& Beasley)

## **E**

### **Economical**

Not wasteful or extravagant It means getting the right amount of resources, of the right quality, delivered at the right time and place at the lowest cost.

### **Economy**

- Minimizing the cost of resources used for an activity, having regard to the appropriate quality. (INTOSAL, auditing standards)
- Acquisition at the right time and at the lowest cost of financial human and material resources which are suitable in terms of both quality and quantity. (glossarium)

➤ **Edit Checks**

Programmed controls built into the early stages of the input process to identify erroneous data fields. For example, alphanumeric characters entered into numerical fields can also be applied for example, when transactions data enter the processing cycle from another application.

**Effective**

Refers to the accomplishment of objectives or the extent to which the outcomes of an activity match the objective or the intended effects of that activity.

**Effectiveness**

- The extent to which objectives are achieved and the relationship between the intended impact and the actual impact of an activity. (INTOSAI, auditing standards)
- Extent to which the stated objectives have been attained in a cost-effective way (glossarium).

**Efficient**

Refers to the resources used to achieve those objectives. It means the minimum resource inputs to achieve a given quantity and quality of output, or a maximum output with a given quantity and quality of resource inputs.

**F**

**Flowchart**

A diagrammatic representation of the client's documents and records, and the sequence in which they are processed. (Arens, Elder& Beasley)

**Flow-charting**

Illustrates a flow of procedures, information or documents. This technique makes it possible to give a summary description of complex circuits or procedures. (glossarium)

## **Fraud**

- An unlawful interaction between two entities, where one party intentionally deceives the other through the means of false representation in order to gain illicit, unjust advantage. It involves acts of deceit, trickery, concealment, or breach of confidence that are used to gain some unfair or dishonest advantage. (XVI INCOSAI ,Uruguay, 1998)
- The term 'fraud' refers to an intentional act by one or more individuals among management, employees, or third parties, which results in a misrepresentation of financial statements. (IFAC)
- An intentional misstatement of the financial statements( Arens, Elder& Beasley)

## **G**

### **General Controls**

- General controls are the structure, policies and procedures that apply to all or a large segment of an entity's information systems and help ensure their proper operation. They create the environment in which application systems and controls operate.
- Policies and procedures that help ensure the continued, proper operation of computer information systems. They include controls over information technology management, information technology infrastructure, security management, and software acquisition, development and maintenance. General controls support the functioning of programmed application controls. Other terms sometimes used to describe general controls are general computer controls and information technology controls. (COSO ERM)

## **I**

### **Independence**

- Freedom given to an audit body and its auditors to act in accordance with the audit powers conferred on them without any outside interference. (glossarium)

- The freedom of the SAI in auditing matters to act in accordance with its audit mandate without external direction or interference of any kind.(INTOSAI auditing standards)
- The auditor's ability to maintain an unbiased viewpoint in the performance of professional services(independence in fact) (Arens, Elder & Beasley)
- The auditor's ability to maintain an unbiased viewpoint in the eyes of others (independence in appearance). (Arens, Elder& Beasley)

### **Inherent Limitations**

Those Limitations of all internal control systems. The limitations relate to the limits of human judgment; resource constraints and the need to consider the cost of controls in relation to expected benefits; the reality that breakdowns can occur; and the possibility of management override and collusion. (COSO 1992)

### **Inherent Risk**

The risk to an entity in the absence of any actions management might take to alter either the risk's likelihood or impact. (COSO ERM)

### **Institute of Internal Auditors (IIA)**

The IIA is an organisation that establishes ethical and practice standards, provides education, and encourages professionalism for its members.

### **Integrity**

The quality or state of being of sound moral principle; uprightness, honesty and sincerity; the desire to do the right thing, to profess and live up to a set of values and expectations. (COSO 1992)

### **Internal Audit**

The functional means by which the managers of an entity receive an assurance from internal sources that the processes for which they are accountable are operating in a manner which will minimise the probability of the occurrence of fraud, error or inefficient and uneconomic practices. It has many of the characteristics of external audit

but may properly carry out the directions of the level of management to which it reports (INTOSAI auditing standards)

Internal auditing is an appraisal activity established within an entity as a service to the entity. its function include, amongst other things, examining, evaluating and monitoring the adequacy and effectiveness of the accounting and internal control systems. (IFAC)

### **Internal Auditor(s)**

Examine the effectiveness of the internal control system and recommend improvements, but they don't have primary responsibility for establishing or maintaining it.

### **Internal Audit Unit**

Department (or activity) within an entity, entrusted by its management with carrying out checks and assessing the entity's systems and procedures in order to minimise the likelihood of fraud, errors and inefficient practices. Internal audit must be independent within the organization and report directly to management. (Glossarium)

### **Internal Control**

- Internal control is an integral process that is affected by an entity's management and personnel and is designed to provide reasonable assurance that the following general objectives are being achieved; fulfilling accountability obligations, complying with applicable laws and regulations, executing orderly, ethical, economical, efficient and effective operations and safeguarding resources against loss.
- All the procedures and means making it possible to comply with the budget and the rules in force, to safeguard assets, ensure the accuracy and reliability of accounting data and facilitate management decisions, in particular by making financial information available at the appropriate time. (glossarium)
- The whole system of financial and other controls, including the organisational structure, methods, procedures and internal audit, established by management within its corporate goals, to assist in conducting the business of the audited entity in a regular economic, efficient and effective manner; ensuring adherence to management policies; safeguarding assets and resources: securing the accuracy and completeness

of accounting records: and producing timely and reliable financial and management information.(INTOSAI auditing standards).

- An internal control system consists of all the policies and procedures (internal controls) adopted by the management of an entity to assist in achieving management's objective of ensuring, as far as practicable, the orderly and efficient conduct of its business, including adherence to management policies, the safeguarding of assets, the prevention and detection of fraud and error, the accuracy and completeness of the accounting records, and the timely preparation of reliable financial information. The internal control system extends beyond these matters which relate directly to the functions of the accounting system. (IFAC)
- A process designed to provide reasonable assurance regarding the achievement of management's objectives in the following categories; (1) Reliability of financial reporting. (2) Effectiveness and efficiency of operations, and (3) Compliance with applicable laws and regulations. (Arens, Elder& Beasley)
- A process, affected by an entity's board of directors, management and other personal, designed to provide reasonable assurance regarding the achievement of the following objectives Effectiveness and efficiency of operations, Reliability of financial reporting and Compliance with applicable laws and regulations. (COSO 1992)

### **Internal Control System (or Process, or Architecture)**

A synonym for Internal Control, applied in an entity. (COSO 1992)

### **International Organisation of Supreme Audit Institutions (INTOSAI)**

An international and independent body which aims at promoting the exchange of ideas and experience between supreme audit institutions in the sphere of public financial control. (INTOSAI auditing standards)

### **Input**

Any data entered into a computer or the process of entering data into the computer.

## **L**

### **Legislature**

The law making authority of a country, for example a Parliament. (INTOSAI auditing standards)

### **Logical access**

The act of gaining access to computer data. Access may be limited to "read only", but more extensive access rights include the ability to amend data, create new records, and delete existing records. (See also physical access)

## **M**

### **Mainframe**

A high-level computer designed for the most intensive computational tasks. Mainframe computers are often shared by multiple users connected to the computer by terminals.

### **Management**

Comprise officers and others who also perform senior management functions. Management includes directors and the audit committee only in those instances when they perform such functions. (IFAC)

### **Management Intervention**

Management's actions to over rule prescribed policies or procedure for legitimate purposes: management intervention is usually necessary to deal with non-recurring and non-standard transactions or events that otherwise might be handled inappropriately by the system.

(contrast this term with Management Override) .(COSO 1992)

### **Management Override**

Management's overruling of prescribed policies or procedures for illegitimate purposes with the intent of personal gain or an enhanced presentation of an entity's financial condition or compliance status (contrast this term with management Intervention).(COSO 1992)

## **Management Process**

The series of actions taken by management to run an entity. Internal Control is a part of and integrated with the management process. (COSO 1992)

## **Manual Controls**

Controls performed manually, not by computer (contrast with Computer Controls). (COSO 1992)

## **Monitoring**

- Monitoring is component of internal control and it is the process that assesses the quality of the internal control system's performance over time.

## **N**

## **Network**

In information technology, a group of computers and associated devices that are connected by communications facilities. A network can involve permanent connections, such as cables, or temporary connections made through telephone or other communications links, a network can be as small as a local area network consisting of a few computers, printers. And other devices or it can consist of many small and large computers distributed over a vast geographic area.

## **O**

## **Operations**

- Used with "objectives" or "controls": having to do with the Effectiveness and efficiency of an entity's activities, including Performance and profitability goals, and safeguarding resources. (COSO 1992)
- The functions, processes, and activities by which an entity's objectives are achieved.

## **Orderly**

Means in a well-organised way, or methodically.

**Output**

In information technology, data/ information produced by computer processing, such as graphic display on a terminal or hard copy.

**P****Physical Access**

In access control, gaining access to physical areas and entities. (See logical access)

**Policy**

Management's dictate of what should be done to effect control. A Policy serves as the basis for procedures for its implementation. (COSO 1992)

**Preventive control**

A control designed to avoid unintended event or result (contrast with Detective control). (COSO 1992)

**Procedure**

An action that implements a policy. (COSO 1992)

**Processing**

In information technology, the execution of program instructions by the computer's central processing unit.

**Public accountability**

The obligations of persons or entities, including public enterprises And corporations, entrusted with public resources to be answerable For the fiscal, managerial and program responsibilities that have been Conferred on them, and to report to those that have conferred these responsibilities on them. (INTOSAI auditing standards)

## **Public sector**

The term 'public sector' refers to national governments, regional (for example, state, provincial, territorial) government, local (for example, city, and town) governments and related Government entities (for example, agencies, boards, commissions and enterprises).

(IFAC)

## **R**

### **Reasonable Assurance**

Equates to a satisfactory level of confidence under given considerations of costs, benefits, and risks.

- The concept that internal control, no matter how well designed and operated cannot guarantee that an entity's objectives will be met. This is because of Inherent Limitations in all internal control systems. (COSO 1992)

### **Risk**

The acceptance by auditors that there is some level of uncertainty in performing the audit function. (Arens, Elder& Beasley)

The possibility that an event will occur and adversely affect the Achievement of objectives. (COSO ERM)

### **Risk Appetite**

- Risk appetite is the amount of risk to which the entity is prepared to be exposed before it judges action to be necessary.
- The broad-based amount of risk a company or other entity is willing to accept in pursuit of its mission or vision. (COSO ERM)

### **Risk Assessment**

- Risk assessment is the process of identifying and analysing relevant risks to the achievement of the entity's objectives and determining the appropriate response.

### **Risk Evaluation**

Means estimating the significance of a risk and assessing the likelihood of the risk occurrence.

### **Risk Tolerance**

The acceptable variation relative to the achievement of objectives.(COSO FRM)

## **S**

### **Securing Program**

An organization-wide program for security planning and management that forms the foundation of an organisations security control structure and reflects senior management’s commitment to addressing security risks. The program should establish a framework and continuing cycle of activity for assessing risk, developing and implementing effective security procedures, and monitoring the effectiveness of these procedures.

### **Segregation (or separation) of duties.**

- To reduce the risk of error, waste, or wrongful acts and the risk of not detecting such problems, no singular individual or Section should control all key stages (authorising, processing, recording, reviewing) of a transaction or event.
- Segregation of the following activities in an organisation: custody of assets, accounting, authorisation, and operational responsibility. (Arens, Elder& Beasley)

### **Service Continuity Control**

This type of control involves ensuring that when unexpected events occur, critical operations continue without interruption or are promptly resumed and critical and sensitive data are protected.

### **Stakeholders**

Parties that are affected by the entity, such as shareholders, the communities in which the entity operates, employees, customers and suppliers. (COSO ERM)

### **Supreme Audit Institution (SAI)**

- The public body of a State which, however designated, constituted or organised, exercises by virtue of law the highest public auditing function of that State.(INTOSAI auditing standards)
- The public body of a State which, however designated, constituted or organized, exercises by virtue of law, the highest public auditing function of that State.(IFAC)

### **System software**

Software primarily concerned with coordinating and controlling hardware and communication resources, access of files and records, and the control and scheduling of applications.

### **System software controls**

Controls over the set of computer programs and related routines designed to operate and control the processing activities of computer equipment.

## **U**

### **Uncertainty**

Inability to know in advance the exact likelihood or impact of future events (COSO ERM)

## **V**

### **Value for Money**

See Economy, Effectiveness and Efficiency.

## **Chapter-7**

### ***AUDIT OF FRAUD AND CORRUPTION CASES***

#### **7.01 Introduction**

Examination of system for detection and prevention of fraud and corruption will be an integral part of all regularity audits and of performance audits, when it forms one of the audit (sub) objectives.

#### **7.02 Fraud examination**

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

- being alert for situations control weaknesses 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:

#### **7.03 Characteristics of fraud**

**7.03.01** 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.

**7.03.02** The meaning and nature of Fraud can be understood by referring to the following definition:

- Fraud is an intentional act by one or more individuals among management those charged with government 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.

**7.03.03** 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 of the audited entity.

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

**7.03.05** 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 object of the act is to obtain or give illegal advantage in violation of the laws, rules and guidelines existing on the subject:
- The intention, collusion and object of obtaining illegal advantage will have to be present when a particular act is committed. 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
- Normally and such act would cause loss to exchequer or be against public interest.

**7.03.06** **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.

**7.03.07** The mandate of Government Audit is broader than solely that of financial statement auditor and includes responsibility for verification of regularity and performance. Hence the auditor should be aware of the possibility of fraud not only in the preparation and presentation of financial statements but in other areas covered by regularity (compliance) and performance audits as well.

### **Considerations of materiality**

**7.03.08** Assessments of materiality in Government Audit may often not be restricted to risks of material misstatements in the financial statement, but comprise fraud in the context of the broader scope of Government Audit. While determining materiality levels for different audit areas adjustments to the materiality level that may make audit more responsive to risk arising from fraud and corruption should be considered.

**7.03.09** In Government auditing, it might be appropriate to set lower materiality levels than the private sector auditing to ensure higher levels of accountability of the audited entity and various legal and regulatory requirements. The occurrence of fraud may lead to a qualification of audit opinion even when the fraud is disclosed in the financial statements.

**7.03.10** Though traditionally materiality has been one of the prime factors to determine the audit priority in case of fraud detection since the act is illegal, materiality assumes lower significance. Although the temptation of embezzlement of a lower amount is much less lack of internal controls may lead to a series of misdemeanors all of small amounts.

**7.03.11** Audit can not always establish and determine whether a misrepresentation was an error or fraud. While Audit looks at records, fraud examination goes beyond audit. Hence, Audit can put red flags (an indication that further scrutiny of the items

would be required) which need further investigation by appropriate agencies and reporting the result to audit.

#### **7.04 Characteristics of Corruption**

**7.04.01** 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.

**7.04.02** 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 camouflages and
- Corruption involves breach of trust.

#### **7.05 Nexus between fraud and corruption**

**7.05.01** Corruption and fraud are not mutually exclusive. There is, in most cases a nexus between the two.

**7.05.02** Fraud is most likely to involve deliberate misrepresentation of information that is recorded and summarized by an entity: its impact can be compared to an

accounting error and would involve issues such as measurement occurrence and disclosure. Fraud poses a serious problem from an audit perspective because it is normally accompanied by efforts to cover/ falsify/ misdirect the entity records and reporting. Thus, fraud can directly affect the financial statements and records of the audited entity.

**7.05.03** Quite often the efforts to misrepresent may involve the management itself. When management gets involved in the perpetration of fraud, the activity assumes the proportion or the additional bearing of corruption. Fraud and corruption are therefore interlinked although certain types of fraud do not necessarily qualify for being viewed as corruption and can be perpetrated by an individual or a small group to cover lapses.

**7.05.04** One problem which corruption poses for audit is that it is linked with the acts of bribery. It is possible to conceive of situations where bribery may have a direct impact on financial statements for example, where a tax officer collects a bribe from an entity to provide a tax relief or where an entity pays an influential decision maker a bribe to secure a contract. In such situations the issue of proper disclosures is involved because the corrupt practice of the illegal payment expense is normally covered up through an accounting compliance or reporting fraud.

**7.05.05** In some cases, corruption may have only a consequential and not a visible and direct effect on the accounting records. For example, when the quality specifications are compromised in a supply order to benefit a supplier.

**7.05.06** In many instances, corruption does not necessarily reflect in the transactions that are recorded and reported by the entity. This especially applies to situations where a position of authority or discretion available under rules is misused by an official. Such corruption does not normally get reflected in information that comes in the purview of audit. For example, when a tax officer collects bribery to give a refund, which is lawfully due to a taxpayer. Thus, whereas the loss to the auditee is usually fairly apparent in cases of fraud in the case of corruption the corrupt employee may benefit from the act but there may not be any loss to the auditee or effect on financial information.

**7.05.07** Both fraud and corruption are without proper authority and involve breach of trust and therefore are illegal or irregular. They also involve an element of non-transparent conduct or behavior. In fact corruption is a special type of fraud and treated as such in many jurisdictions. In any case audit teams officers should be well aware of the complex distinction as well as correlation between the two.

## **7.06 Types of Fraud and Corruption**

There are several types of fraud and corruption. Some illustrative types (relating to contracting for goods and services) are indicated in Appendix- A.

## **7.07 Respective Responsibilities of Management and Audit**

### ***Responsibilities of Management***

**7.07.01** It is the responsibility of those charged with governance of the entity to ensure rough 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.

**7.07.02** In relation to fraud, it is important to recognise 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 rest 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.

### ***Responsibilities of Audit***

**7.07.03** 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 the absence or lack of application of reliable and valid performance measures and indicators should increase the possibility of occurrence of fraud and corruption.

**7.07.04** 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.

**7.07.05** Any indication that an irregularity illegal act, fraud or error may have occurred which could have a material effect on the audit finding opinion should cause the auditor to extend procedures to confirm or dispel such suspicions.

**7.07.06** It should be borne in mind that if a material fraud was perpetrated but not discovered in audit the conduct, of audit personnel can be called in question. Particularly if the evidence was such as would arouse suspicion in an auditor of normal prudence. Hence the audit personnel need to be aware of the possibilities of fraud at the planning stage and should be vigilant while carrying out the audit work.

## **7.08 Considerations of Fraud in Audit of Financial Statements.**

**7.08.01** 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.

**7.08.02** Fraudulent financial reporting involves intentional misstatements including omissions of amounts or disclosures in financial statements to deceive financial statement users. Fraudulent financial reporting may be accomplished by the following:

- Manipulation falsification (including forgery) or alteration of accounting records or supporting documentation from which the financial statements are prepared.
- Misrepresentation in or intentional omission from the financial statements of events, transactions or other significant information and,
- Intentional misapplication of accounting principles relating to the amounts classification manner of presentation or disclosure etc.

**7.08.03** Misappropriation of assets involves the theft of entity assets and can be perpetrated by employees as well as management.

**7.08.04** The objective of an audit of financial statements is to enable the auditor to express an opinion whether the financial statements are prepared in all material respects in accordance with an applicable financial reporting framework. An auditor obtains reasonable assurance that the financial statements taken as a whole are free from material misstatement whether caused by fraud or error. An auditor can not obtain absolute assurance that material misstatements in the financial statements will be detected because of such factors as the use of judgment the use of testing. The inherent limitations of internal control and the fact that much of the audit evidence available to the auditor is persuasive rather than conclusive in nature.

### **7.09 Considerations of Fraud in Receipt Audit**

**7.09.01** Audit should not, in any way substitute itself for the revenue authorities in the performance of their statutory duties. However, Auditors should satisfy themselves that the requirements of legality and regularity are observed in individual assessments and in general that the department machinery is sufficiently safeguarded against error, fraud and corruption.

**7.09.02** In the audit of receipts, it would be necessary in the case of a department which is a receiver of public moneys to ascertain what arrangements (internal controls) are in place to ensure the prompt detection investigation and prevention of irregularities double refunds fraudulent or forged refund vouchers or other loss of revenue through fraud, error or willful omission or negligence to levy or collect taxes or to make refunds. Auditors may also suggest appropriate improvements in the systems and procedures for prevention detection and reporting of cases of fraud and corruption.

### **7.10 Considerations of Fraud in Audit of World Bank and other Externally Assisted Projects**

Audit is responsible for reporting to the funding agency whether the implementing agencies have carried out expenditure on the scheme in accordance with the pattern specified in the project appraisal report relating to the schemes and terms of such assistance and Government of India instruction and to identify matters relating to

inadequacies in systems and control, cases of fraud or presumptive fraud, wasteful expenditure and failure of administration to take corrective action on recommendations contained in earlier report.

## **7.11 Professional skepticism**

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

**7.11.02** Due to the characteristics of fraud the auditor's attitude of professional skepticism assumes particular importance when considering the risks of fraud having material effect. When obtaining reasonable assurance, an auditor should maintain an attitude of professional skepticism throughout the audit, consider the potential for management override of controls and recognize the fact that audit procedures that are effective for detecting error may not be appropriate in the context of an identified risk of fraud having material effect. This is notwithstanding the auditors past experience with the entity about the honesty and integrity of management and those charged with governance.

## **7.12 Fraud awareness at the Audit planning stage**

### ***Risk assessment***

**7.12.01** 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. For instance, those areas indicated at paragraph 13.8 (in fraud)

**7.12.02** Though audit cannot insure against frauds, the possibility of their occurrence should be kept in mind while preparing for and conducting audit by maintaining an attitude of professional skepticism.

**7.12.03** While planning his audit the auditor should assess the risk that fraud may cause the financial statements to contain material misstatement or record material irregular transactions.

**7.12.04** The auditor may keep in view that the risk of fraud and corruption could be higher in certain organisations like those involved in procurement of goods and services.

**7.12.05** The auditor should have a complete understanding of the audited entity including the environment in which the entity operates the level of internal control and the past performance of the audited entity especially previous instances of fraud and corruption.

**7.12.06** Based on the risk assessment, the auditor should develop the audit objective and design audit procedures so as to have reasonable expectation of detecting and evaluating material misstatement and irregularities arising from fraud and corruption. In case of high risk audit, the audit team should be selected keeping in view the requirement of such audit.

**7.12.07** The field offices should keep in view the need for flexibility in terms of budget time and expertise of the audit team particularly when fraud and corruption are suspected or discovered in the course of audit.

### **Identification of areas requiring attention**

**7.12.08** An understanding of the audited entity should enable the auditor to identify potential high-risk areas and suitably modify audit procedures and techniques given the complexity of transactions and refinement of audit methodologies across the globe taking expenditure as the sole criterion is simplistic and unsophisticated. The broader definition of fraud risk should cover areas of specific concern to the Government Auditor although potentially not having a material impact on the financial statements. Some of the common high risk areas illustrative are:

- contracts of service procurement (for example the fraud risk includes violation of prescribed laws and regulations concerning the procedures for inviting receiving and processing of tenders selection of bidders)

- inventory and asset management.
- sanctions clearances.
- programme management and performance management information:
- revenue receipts (for example, incorrect valuation of goods, inadmissible duty draw back claims, misuse of exemptions and notifications regarding refund claims, embezzlement / lament through incorrect account of receipts etc.)
- cash management;
- expenditure on AC bills;
- grants (like grants-in-aid to autonomous bodies non-governmental organisations: for example the fraud risk includes violation of prescribed conditions in providing and administering grants by the Government Departments or in spending by the recipients. intentional misstatements in financial reporting in order to receive unlawful grants);
- financial statements;
- operating information(for example, the fraud risk includes overstatement/ understatement of accomplishments, progress in meeting performance goals, number of citizens served, programme improvements compliance with policies, etc irrespective of whether the possible fraud is related to the entities (financial statements)
- computerized environment;
- privatization of public sector functions (for example, the fraud risk includes non-adoption of open competitive process, manipulation of bidding terms and evaluation criteria, etc) joint ventures public-private partnerships, etc;
- any other areas involving public interface (for example the fraud risk includes fraud in exercise of public authority like issuing of regulations, permissions and concessions)

**7.12.09** As the first step during the preliminary Systems Evaluation, the adequacy of various accounting systems and procedures whether set out in the form of a manual or otherwise should be examined and the extent of check of individual transactions should be determined based on the results of such examination. This is all the more necessary since generally a sample of the transactions is checked in audit and audit personnel cannot escape responsibility if significant deficiencies in the accounting systems and procedures lead to misuse or abuse of public moneys. The concept of Systems Audit is that if an-in-depth analysis of the mechanics of a system reveals that it is designed with appropriate controls. checks and balances to safeguard against errors frauds, etc.. Audit can reasonably assume without the necessity of undertaking a detailed examination of the individual events or transactions that the results produced by the system would be fairly accurate. Evaluation of the efficiency and effectiveness of any system will however require sample testing of its actual working.

### **7.13 Vigilance about fraud at audit execution stage**

#### **Vigilance during the course of audit**

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

**7.13.02** Auditors need to be alert to deviations from acceptable accounting standards including disclosure requirements, particularly when there is suspicion of fraud and corruption.

**7.13.03** The auditor may keep in view that when a fraud is conducted, there is a deliberate effort to conceal the facts and distract the auditor.

**7.13.04** Some possible fraud indicators (red flag areas) are given in Appendix-B. They are illustrative only and should not be taken as exhaustive. The audit personnel should exercise professional skepticism and professional judgment in dealing with possible fraud indicators.

**7.13.05** It should also be recognised that failure to appreciate the significance of what appears to be a trifling irregularity may result in failure to discover an important fraud or defalcation. Therefore notice may be taken of the cumulative effect of numerous

petty errors or irregularities as being indicative of carelessness and inefficiency in the maintenance of accounts or in financial administration generally.

**7.13.06** If no satisfactory explanations are offered and the auditor suspects that irregularities may have occurred, he should probe the matter further and inform management of the audited entity. If the irregularities had a material effect on the accounts suitable qualification in the accounts may be warranted. Audit should also recommend improvement in the control procedures to management for preventing recurrence of bad practices and/or irregularities.

### **Information to be sought from the audited entity management**

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

**7.13.08** 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.

## **7.14 Audit Evidence**

### **Nature of Evidence**

**7.14.01** The auditors should clearly understand that the audit evidence obtained can be only persuasive and not conclusive. Yet the evidence in case of suspected fraud and corruption ought to be closer to conclusive. While reporting all cases of suspected fraud

or corruption, they should refrain from making any judgment regarding the existence of fraud or corruption but should suggest suspected fraud/ corruption or presumptive fraud.

### **Some illustrative checks**

**7.14.02** Analytical procedures are helpful in identifying the existence of unusual transactions or events and amounts, ratios and trends that might indicate matters having audit implications. When performing analytical procedures at the planning stage or during the course of audit, unusual or unexpected relationships may indicate risk of fraud.

**7.14.03** Fraud detection measures need to be built in the audit procedures so that during the audit, the auditor can highlight a transaction for a possible fraud or identify such consistent system failures which can lead to a fraud. Some of the checks which could be applied to determine the red flag items during the course of audit are illustrated below:

- examine the use of delegation of powers particularly in vulnerable areas;
- examine the effectiveness and adequacy of internal controls in various areas'
- check for collusion between the supplier and employees/ management
- examine cases of misuse of financial powers;
- check for false statements and false claims: whether information presented to justify a transaction is incorrect and at the point of time when such information was presented the person submitting the information had access to correct information.
- examine evidence for certification split purchases, collusive bidding, over and under invoicing and making payments on the basis of false progress reports::
- check for loss of revenue due to evasion and/or non-accountable or receipt:
- examine for payment made for services/ supplies not received;
- seek confirmation with other related parties;
- checking of cross-linking of documents for evidence or known wrongdoing: and
- cases of misclassification etc.

## **Fraud Specific Internal Controls**

**7.14.04** As regards fraud specific internal control there could be two types of such controls. viz., active internal controls and passive internal controls. Examples of active internal controls can be the following:

- (i) Signatures and document countersigning procedures:
- (ii) Segregation of duties and functions:
- (iii) Physical asset control:
- (iv) Real time inventory control:
- (v) Document matching and cross linking of documents

**7.14.05** Wherever the management of the audited entity makes changes and improvements in the internal control system either due to changes in its environment or as a response to previous instances of fraud and corruption such changes and improvements should be particularly studied and evaluated during audit.

**7.14.06** Since complete evidence about cases of fraud and corruption may not be available to audit, due care should be exercised in arriving at an audit conclusion. In many circumstances additional tests may have to be performed and additional evidence acquired than would normally be considered appropriate and necessary for arriving at an audit opinion.

**7.14.07** Whenever a material instance of failure to comply with the applicable laws and regulations is observed the auditor should without automatically assuming the management and staffs are dishonest investigate the control failure with an appropriate degree of professional skepticism. He may also examine if the supporting evidence has been tampered in any manner or any individuals(s) could have benefited from the material violation.

**7.14.08** When auditors suspect the possibility of fraud and corruption, they should establish whether it has taken place and there has been resultant effect on the financial reporting especially whether the audit certificate requires qualification. Similar

considerations apply in case of performance audits where there has been effect on the programme execution or performance reporting

**7.14.09** When auditors intend to report on fraud and corruption they should ensure the reliability of audit evidence by verifying it with source documents including third party evidence. Auditors should carefully determine how much evidence they should gather in support of audit findings. Auditors should also keep in view the possibility that the evidence gathered by them and their findings could become the basis for legal or disciplinary proceedings.

**7.14.10** In determining overall responses to address the risk of fraud the auditor should:

(a) evaluate the accounting and reporting policies used by the entity particularly those related to subjective measurements and complex transactions and

(b) Incorporate an element of unpredictability in the selection of the nature, timing and extent of audit of audit procedures for example:

- performing substantive procedures on selected account balances and assertions not otherwise tested due to their materiality or risk:
- adjusting the timing of audit procedures from that otherwise expected.
- using different sampling methods:
- performing audit procedures at different locations or at locations on an unannounced basis:
- use computer assisted audit techniques to gather more evidence about data contained in significant accounts or electronic transaction files to select sample transactions from key electronic files to sort transaction with specific characteristics or to test an entire population instead of a sample:
- design external confirmations:
- supplement such external confirmations with inquiries of non- financial personnel in the entity:

- performing more substantive testing at or near the period end; and
- performing analytical procedures at a more detailed level etc.

**7.14.11** The auditor may identify a risk of material misstatement due to fraud affecting a number of accounts and assertions, including asset valuation, estimates relating to specific transactions and other significant accrued liabilities. The risk may also relate to significant changes in assumptions relating to recurring estimates. Information gathered through obtaining an understanding of the entity and its environment may assist the auditor in evaluating the reasonableness of such management estimates and underlying judgments and assumptions. A retrospective review of similar management judgments and assumptions applied in prior periods may also provide insight about the reasonableness of judgments and assumptions supporting management estimates.

**7.14.12** To respond to the risk of management override of controls the auditor should design and perform audit procedures to:

- (a) test the appropriateness of journal entries and other adjustment made in the preparation of financial statements.
- (b) review accounting estimates for biases that could result in material misstatement due to fraud: and
- (c) obtain an understanding of the business rationale of significant transactions that the auditor becomes aware of that are outside of the normal course of business (operations) for the entity or that otherwise appear to be unusual given the auditor's understanding of the entity and its environment.

**7.14.13 Computer Evidence**

Since many records are produced by computers in the usual and ordinary course 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.

#### **7.14.14 Compliance with the provisions of GFRs.**

The Audit personnel should also check compliance with the provisions of Rules 33.34.37 and 38 of the General Financial Rules (GFRs) 2005 (Rules 16 to 19 and 21 of earlier GFRs) regarding

- reporting losses or shortages of public money, departmental revenue or receipts, stamps, opium stores or other property held by or on behalf of Government irrespective of the cause of loss and manner of detection by the subordinate authority concerned to the next higher authority as well as to the Statutory Audit Officer and to the concerned Principal Accounts Officer, even when such loss has been made good by the party responsible for it except cases which need not be reported under the provisions of the GFRs.
- bringing cases involving serious irregularities to the notice of Financial Adviser or Chief Accounting Authority of the Ministry or Department concerned and the Controller- General of Accounts Ministry of Finance, redrawing of amounts lost through misappropriation defalcation embezzlement etc. bearing of loss to Government on account of culpability of Government servants by the Central Government Department or State Government concerned with the transactions
- making recovery from the erring Government officials:
- reporting of all cases involving loss of Government money arising from erroneous or irregular issue of cheques or irregular accounting of receipts will be reported to the Controller-General of Accounts along with the circumstances leading to the loss to enable him to take steps to remedy defects in rules or procedures. if any connected there with:
- reporting of losses above the prescribed value due to suspected fire theft, fraud, etc to the Police for investigation as early as possible: obtaining a formal investigation report should be obtained from the Police Authorities in all cases which are referred to them:
- fixing of responsibility for loss on the concerned officers:

- prompt disposal of cases of loss at each stage of detection, reporting write off, final disposal in cases of losses including action against delinquents and remedial measures.

**7.14.15** Extracts of the provisions of these rules have been given in Appendix-C

**7.14.16** As the rules may be amended from time to time the auditors should ascertain the latest Rules applicable and check compliance.

**7.14.17** Non-reporting of losses or shortages of public moneys departmental revenue etc as required by GFRs can be an indicator suggesting non-transparency and the presence of an element of fraud or corruption (though not conclusive).

**7.14.18** Non-compliance with provisions in Rule 29 of the GFRs for endorsement of sanction to the Audit Officer could also be an indicator for fraud or corruption in some cases. The risk of non-compliance with GFRs from fraud and corruption angle should also be investigated.

## **7.15 IT Fraud**

**7.15.01** 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.

**7.15.02** Computers provide opportunities for their misuse for economic or financial gains. Computer networks can be used to commit crimes from geographically far off places. Frauds committed using computers vary from complex financial frauds to the simpler frauds where computer is only a tool to commit a crime. With some State Governments Union Government Departments and public sector organisations going for e-commerce/ e-payment systems in a large way, possibility of electronic fraud requires attention.

**7.15.03** IT frauds are committed by insiders, outsiders, vendors, competitors etc. Such frauds are committed by manipulation of input, output or throughput of a computer system. Fraud can also be committed by hacking into the system for causing deliberate damage.

### ***Role of Audit in relation to IT fraud***

**7.15.04** 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.

**7.15.05** The steps in prevention of frauds in computerized systems involve setting up of proper access controls both physical and logical. Physical access controls ensure against unauthorized access to computerized system and logical access controls prevent unauthorized access to data and software for its use and manipulation.

**7.15.06** For auditors the most effective tool is data enquiry analysis and reporting software. Powerful interactive software like ACL and IDEA can quickly sift through voluminous electronic data and assist in the detection and prevention of fraud in an organization. They can be used to process normal data as well as exception reports and audit trails but demand flexibility and creativity on the part of the auditor. The auditor should have capability to revise and upgrade queries based on the findings from previous queries. Besides having auditing skills it is important that auditors have intimate knowledge of computerized system to understand the possible modes of fraud so that they can isolate all types of risk to the organisation.

**7.15.07** Increasing use of IT systems by auditee requires that the auditor should have access to reliable and verifiable system based audit trails to evaluate the internal control. 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 perpetrator of fraud and how data can be accessed and manipulated. It is particularly important for the auditor of the IT system to assess in his audit the level of security controls built in and if these are in tune with the sensitivity of data.

**7.15.08** In case of fraud involving use of computer systems the audit personnel should also comply with the instructions on Information Technology Audit (IT Audit)

issued by the IT Audit Wing of Headquarters Office and the Comptroller and Auditor General's Manual of Standing Orders (Audit).

## **7.16 Documentation**

**7.16.01** The auditors should collect adequate documentation which may provide evidence during subsequent enquiries investigations court cases etc.

**7.16.02** The documentation should include inter alia;

- (a) The identified and assessed risks of fraud the overall response of the auditor to the assessed risk of fraud and the nature timing and extent of audit procedures and the linkage of those procedures with the assessed risk of fraud:
- (b) The results of the audit procedures including those designed to address the risk of management override of controls:
- (c) Communications about fraud made to management etc.

**7.16.03** The documentation should also be capable of proving that the Audit personnel have discharged their functions with reasonable care and due diligence and should enable a review of working procedures and working papers.

## **7.17 Supervision and review**

Supervision and review of the work of audit personnel shall be exercised in accordance with the Auditing Standards of the Comptroller and Auditor General of India and instructions issued from time to time.

## **7.18 Reporting**

### ***Initial reporting***

**7.18.01** 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. In the case of Controlling Officer based audits the report should be sent confidentially to the concerned Controlling Officer (with a copy to the Chief Controlling Officer concerned)

whereas in the case of Drawing and Disbursing Officer based audits the report should be sent confidentially to the concerned Drawing and Disbursing Officer (with a copy to the Controlling Officer concerned).

**7.18.02** The situation events that may be suggestive of fraud, presumptive fraud should be highlighted in the inspection reports with a recommendation to the executive for detailed investigation and response.

**7.18.03** The report of the audit party should indicate, inter alia, the scope of audit main findings total amount involved modus operandi of the suspected fraud or the irregularity accountability for the same and recommendations for improvement of internal control system fraud prevention and detection measures (including changes in the systems and procedures) to safeguard against recurrence or fraud serious financial irregularity.

**7.18.04** 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 and State Vigilance Commission/Lok Ayukta etc in case of State Government with the approval of the Accountant General or by him/her depending upon the seriousness of the cases. In this connection the provisions of paragraphs 19.8 to 19.11 (*infra*) may also be seen.

***Qualification in Audit Opinion on financial statements***

**7.18.05** In case of financial audit, instances of possible fraud and corruption may require making qualification in the Audit Opinion on financial statements, depending upon the materiality of the audit findings. In other cases they may be reported to entity management in a special letter or in the regular inspection reports depending upon the circumstances.

**7.18.06** When in the opinion of the auditor the financial statements include material fraudulent transactions or such transactions have not been adequately disclosed or the audit conducted by the auditor leads him to the inference that instance(s) of fraud

and/or corruption have taken place and when the auditor has adequate evidence to support his conclusion he should qualify the audit certificate/opinion and/or ensure that his findings are adequately included in his audit report. However, the term fraud or corruption may not be used in a conclusive sense unless such action is established in a court of law.

***Printing cases relating to fraud and corruption***

**7.18.07** 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.

***Reporting to investigating agencies***

**7.18.08** Principal Accountant General/Accountant General etc 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.

**7.18.09** While forwarding the Bond Copy or the Audit Reports to Headquarters the Accountant General Principal/Directors of Audit etc 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 the Accountant General 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, Lok Ayukta 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 While forwarding such cases the Accountant General/Principal Director 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.

**7.18.10** The communications to vigilance or investigative authorities should clearly indicate that the audit evidence is obtained from the original documents of the audited entity. They should also indicate that the audit findings are based on the test check carried out and the information and records received from the audited entity. The investigative agency should use information given by us as a lead and make their own examination of the primary/ original records which are available with the audited entity/Department.

**7.18.11** The reporting to the vigilance or investigative authorities may be completed after approval of the bond copy without waiting for the availability of printed Audit Reports. While for the Audit Reports relating to State Government and Union Territories the concerned Accountant General will be the Nodal Officer for the Audit Reports relating to Union Government the reports may be sent by the respective report controlling wings under orders of the ADAI/ DAI concerned.

**7.18.12** In the submission note to CAG of the bond copy the number of cases of fraud and corruption included in the Draft Report should be mentioned together with the money value of concerned paras.

***Post Audit Report letter to the Chief Minister***

**7.18.13** The draft of the annual post-Audit Report letter to the Chief Ministers should contain a brief mention of issues relating to fraud and corruption where such cases appear in the Audit Reports. The field Accountants General should put in place a system of monitoring paras relating to fraud corruption and a brief mention of this should be made in the annual post-audit letters to Chief Ministers. Such letters should be submitted immediately after reports are laid in the State Legislatures.

**7.19 Follow-up**

**7.19.01** The field offices shall institute mechanism for recording the cases of fraud and corruption (including possible indicators of fraud and corruption) noticed during the

course of audit in separate registers maintained for the purpose. Such cases should be followed up vigorously with the concerned audited entity and with higher executive authorities and should not be settled in a routine manner. All significant cases should be followed up with the Secretary of the Administrative Department concerned.

**7.19.02** In following up on reported cases of fraud and corruption the auditor should determine whether the necessary action is being taken with due regard to urgency that the situation demands and become aware of the changes in the systems and procedures which could be validated through subsequent audits.

**7.19.03** The Principal Accountant General/ Accountant General may send annual confidential letters to the Secretaries of the concerned Administrative Departments (in cases where the inspection reports, and notes etc throw light on a pattern of fraud across the Department) indicating the details of the important cases of suspected fraud and corruption.

**7.19.04** It should be noted that once a matter has been referred to the investigative or vigilance agencies, the responsibility and scope of audit is to provide the information and assistance sought by them in accordance with the extant instructions. The matter may however be followed up through discussions in formal meetings with the investigative or vigilance agencies.

## **7.20 Additional Instructions**

Memorandum/ Certificate of Assurance to be obtained from the Audit Party

**7.20.01** The Principal Accountant General/ Accountant General may require the Audit Party to provide a Memorandum/ Certificate of Assurance which should include inter alia, examination of issues relating to fraud and corruption and compliance with the provisions of this Standing Order and other applicable instructions by the Principal Accountant General supported by detailed documentation.

### **Database**

**7.20.02** Each field office should establish a database of fraud or corruption related audit issues for building a linkage across functional groups to identify red flag items.

Change in mode of audit investigation is required to bring out system deficiencies in greater detail rather than mentioning only money value. Red flagged items should bring out the intention and failure of internal control irrespective of money value. The data base should be transparently reviewed by the Principal Accountant General every quarter for further strategy and directions to the field audit parties.

### **Objection Book**

**7.20.03** Cases of fraud or corruption etc should also be recorded along with cases of misappropriation defalcation etc in an Objection Book in accordance with the instructions contained in the Comptroller and Auditor General's Manual of Standing Orders(Audit) as amended from time to time.

### **Skill Development**

**7.20.04** The field offices should have an adequate inventory of skills to deal with cases of fraud and corruption and for this purpose arrange for training of their officials at the Regional Training Centres/ Institutes .

### **Developing sector specific guidelines checklists.**

**7.20.05** The Principal Accountant General/ Accountant General should develop sector specific guidelines/ checklists to deal with cases of fraud and corruption in the audit of entities belonging to specific sectors for the guidance of the field staff deployed in such audits and furnish a copy of such guidelines, checklists to DG (Audit).

### **Reporting to Headquarters**

**7.20.06** The field offices should send half yearly reports on cases of suspected material fraud and corruption noticed by them to the Headquarters Office.

**7.20.07** In view of the ongoing rationalization process of Management Information System (MIS) the half yearly reports may be sent electronically or placed on local intranet in such manner as may be prescribed upon completion of the rationalization of MIS.

**7.20.08** The existing provisions in the Manual of Standing Orders (Audit) relating to reports on defalcation or loss of public money or property and action to be taken thereon shall continue to be in force.

## Appendix-A

### Illustrative fraud and corruption 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 substandard 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 or supplier which may affect the basis on which the contract was awarded to the contractor or supplier 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 or supplier 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 or suppliers 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 or supplier submits inflated invoices.

**False Invoices** - The contractor or supplier 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 specification 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** -Specification and time limits are manipulated to favor a certain contractor or supplier.

**Supply Orders** - in excess of or without establishment the requirement/ need and much ahead of the actual requirement.

## **Appendix-B**

### **Some indicators (red flags) for possible fraud and corruption (illustrative)**

#### **Procurement and contracting of goods and services. 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 rather than needs oriented;
- Someone other than the user defines the user requirements; and
- 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 or suppliers;
- Request for proposal is not properly advertised;
- Unusual handling of the bidding process;
- Evaluation criteria is not consistent for different offerors;
- Exceptions to the tender deadlines;
- Changes in the bids made after their formal receipt;
- Lowest responsive bidder is not selected;
- Contractor or supplier submits unrealistic bid indicating collusion or bid rotation;

- Unusual withdrawal of bids;
- Re-bid results identical to original bids;
- Successful contractors or suppliers use competitors as sub- contractors or sub-suppliers: and
- Justification for single source procurement is inadequate. etc

**Contract performance and evaluation stage:**

- Changes in a contract result in 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: and
- Unduly high labour payments etc.

**Accounting Records**

- Missing vouchers:
- Production of photocopies of documents instead of originals:
- Alterations and erasures in accounting records;
- Any unusual accounting entries;
- Discrepancies between control accounts and subsidiary records;
- Discrepancies between predicted figures and actual figures during analytical review procedures: and

- Employees in sensitive posts not taking leave: etc.

### **Performance Information**

- Performance information about delivery of goods/ services, asset creation etc. not supported by original documents and downstream data;
- Theoretical calculations not supported by actual measurements, muster rolls, inspection notes, quality reports etc.
- Non-production of basic records viz. asset register, muster roll, measurement books etc.
- Non-availability of transparent evidence of expenditure and receipts into Government Account: and
- Inconsistency between financial and physical information about progress of scheme/ work.

(Note- These are only illustrative examples. Principal Accountant General/ Accountant General may please prepare a comprehensive list of 'Red flag' items in audit of various Department/ sectors and establish procedures to ensure that such items are reckoned while planning the audits. Transparently documented and evidence of addressing all such items and their treatment are recorded and retained).

## **Appendix-C**

### **Extracts from the Provisions of General Financial Rules, 2005**

#### **Rule 33. Report of Losses:**

(1) Any loss or shortage of public moneys departmental revenue or receipts stamps opium stores or other property held by or on behalf of Government irrespective of the cause of loss and manner of detection shall be immediately reported by the subordinate authority concerned to the next higher authority as well as to the Statutory Audit Officer and to the concerned Principal Accounts Officer even when such loss has been made good by the party responsible for it. However the following losses need not be reported;

(i) Cases involving losses of revenue due to-

(a) mistake in assessments which are discovered too late to permit a supplementary claim being made.

(b) under assessments which are due to interpretation of the law by the local authority being overruled by higher authority after the expiry of the time-limit prescribed under the law and

(c) refunds allowed on the ground that the claims were time barred:

(ii) Petty losses of value not exceeding Rupees two thousand.

(2) Cases involving serious irregularities shall be brought to the notice of Financial Adviser or Chief Accounting Authority of the Ministry or Department concerned and the Controller-General of Accounts. Ministry of Finance.

(3) Report of loss contemplated in sub-rule (1) & (2) shall be made at two stages-

(i) An initial report should be made as soon as a suspicion arises that a loss has taken place.

(ii) The final report should be sent to authorities in sub rule(1) & (2) after investigation indicating nature and extent of loss, errors or neglect of rules by which the loss has been caused and the prospects of recovery.

(4) The Complete report contemplated in sub-rule (3) shall reach through proper channels to the Head of the Department who shall finally dispose of the same under the powers delegated to him under the Delegation of Financial Power Rules, 1978. The reports which he cannot finally dispose of under the delegated powers shall be submitted to the Government.

(5) An amount lost through misappropriation, defalcation, embezzlement etc may be redrawn on a simple receipt pending investigation recovery or write off with the approval of the authority competent to write-off the loss in question.

(6) In cases of loss to Government on account of culpability of Government servants, the loss should be borne by the Central Government Department or State Government concerned with the transaction. Similarly, if any recoveries are made from the erring Government officials in cash the receipt will be credited to the Central Government Department or the State Government who sustained the loss.

(7) All cases involving loss of Government money arising from erroneous or irregular issue of cheques or irregular accounting or receipts will be reported to the Controller-General of Accounts along with the circumstances leading to the loss, so that he can take steps to remedy defects in rules or procedures if any connected therewith.

**Rule 34. Loss of Government property due to fire, theft, fraud:**

Departmental Officers shall in addition to taking action as prescribed in Rule 33 follow the provisions indicated below in cases involving material loss or destruction of Government property as a result of fire theft fraud etc.

All losses above the value of Rupees ten thousand due to suspected fire, theft, fraud etc. shall be invariably reported to the Police for investigation as early as possible.

Once the matter is reported to the Police Authorities, all concerned should assist the Police in their investigation. A formal investigation report should be obtained from the Police Authorities in all cases which are referred to them.

**Rule 37. Responsibility for Losses:** An officer shall be held personally responsible for any loss sustained by the Government through fraud or negligence on his part. He will

also be held personally responsible for any loss arising from fraud or negligence of any other officer to the extent to which it may be shown that he contributed to the loss by his own action or negligence. The departmental proceedings for assessment of responsibility for the loss shall be conducted according to the instructions contained in Appendix 1 and those issued by the Ministry of Personnel from time to time.

**Rule 38. Prompt disposal of cases of loss:** Action at each stage of detection reporting write off, final disposal in cases of losses including action against delinquents and remedial measures should be completed promptly with special attention to action against delinquents and remedial measures taken to strengthen the control system.

*(Note:- The corresponding provisions in the earlier General Financial Rules are Rules 16,17,18,19 and 21 which should be checked for compliance in relevant cases.)*

## Appendix-1

### **Instructions for regulating the enforcement of responsibility for losses, etc.**

1. The cardinal principle governing the assessment of responsibility is that every Government officer should exercise the same vigilance in respect of expenditure from public fund generally as a person of ordinary prudence would exercise in respect of the expenditure and the custody of his own money. While the competent authority may in special cases condone an officer's honest errors of judgement involving financial loss if the officer can show that he has acted in good faith and done his best up to the limits of his ability and experience personal liability shall be strictly enforced against all officers who are dishonest, careless or negligent in the duties entrusted to them.
2. In cases where loss is due to delinquencies of subordinate officials and where it appears that this has been facilitated by laxity of supervision on the part of a superior Officer, the latter shall also be called strictly to account and his personal liability in the matter carefully assessed.
3. (a) The question of enforcing pecuniary liability shall always be considered as well as the question of other forms of disciplinary action. In deciding the degree of an officer's pecuniary liability it will be necessary to look not only to the circumstances of the case but also to the financial circumstances of the officer, since it should be recognized that the penalty should not be such as to impair his future efficiency.  
(b) In particular, if the loss has occurred through fraud every endeavor should be made to recover the whole amount lost from the guilty persons and if laxity of supervision has facilitated the fraud the supervising officer at fault may properly be penalized either directly by requiring him to make good in money a sufficient proportion of the loss or indirectly by reduction or stoppage of his increments of pay.  
(c) It should always be considered whether the depreciated value of the Government property or equipment lost, damaged or destroyed by the carelessness of individuals entrusted with their care should be recovered from the delinquent official. The depreciated value of the stores may be calculated by applying the 20<sup>th</sup> of depreciation in the case of vehicles including cycles and 15<sup>th</sup> in the case of calculating machines on the reduced balance every year. The amount to be recovered may be limited to the Government servant's capacity to pay.

4. When a pensionable Government servant is concerned in any irregularity or loss the authority investigating the case shall bear in mind the provisions contained in Central Civil Services(Pension ) Rules 1972 as amended from time to time and immediately inform the Audit Officer and or the Accounts Officer as the case may be responsible for reporting on his title to Pension or Death-Cum-Retirement Gratuity and the authority competent to sanction pension or Death-Cum-Retirement Gratuity and it will be the duty of the latter to make a note of the information and see that the Gratuity or Death-Cum-Retirement Gratuity is not paid before a conclusion is arrived at as regards the Government servants culpability and final orders are issued thereon.

5. The fact that Government servants who were guilty of frauds or irregularities have been demobilized or have retired and have thus escaped punishment should not be made a justification for absorbing those who are also guilty but who still remain in service.

6. It is of the greatest importance to avoid delay in the investigation of any loss due to fraud, negligence, financial irregularity etc. Should the administrative authority require the assistance of the Audit Officer in pursuing the investigation, he may call on that officer for all vouchers and other documents that may be relevant to the investigation: and if the investigation is complex and he needs the assistance of an expert Audit Officer to unravel it. He should apply forthwith for that assistance to Government which will then negotiate with Audit Officer concerned for the services of an investigating staff. Thereafter the administrative authority and the Audit authority shall be personally responsible within their respective spheres. for the expeditious conduct of the enquiry. In any case in which it appears that recourse to judicial proceedings is likely the Special Police Establishment or the State Police should be associated with the investigation.

7. Depending upon the results of the inquiry, departmental proceedings and/or prosecution shall be instituted at the earliest moment against the delinquent officials concerned and conducted with strict adherence to the Central Civil Services (Classification, Control and Appeal) Rules and other instructions prescribed in this regard by Government.

**(Authority:** vide CAG's circular No. 126/Audit (AP)/1-2006 dated 6.9.2006)

## **CHAPTER-8**

### ***AUDIT OF ANNUAL ACCOUNTS AND THEIR CERTIFICATION***

#### **8.01. Audit of Annual Accounts**

##### **8.01.01 General**

In the audit of annual accounts, it is to be verified that the transactions appearing in the books of original entries represent legitimate charge and the books themselves record fully and faithfully all transactions pertaining to the organisation for the period under audit and nothing is left out. This can be ensured only by conducting audit of transactions. The procedure for transaction audit has been outlined in the preceding chapter. The instructions contained in this chapter are restricted mainly in connection with the audit of annual accounts which are to be read along with the instructions for audit of transactions. It may be noted that the audit of transactions and audit of annual accounts should be combined and conducted in one spell in cases where the C.A.G. is the sole auditor, unless for any special reason it becomes necessary to under- take audit of transactions separately from the audit of annual accounts.

##### **8.01.02 Essential features of audit of accounts**

The essential features of the audit of annual accounts are as under:-

- (a) to make critical review of the . system of book keeping; accounting and internal control ;
- (b) to make such tests and enquires as the auditor considers necessary to form an opinion as to the reliability of the records as a basis for preparation of accounts;
- (c) to compare the Income and Expenditure Account and the Balance Sheet with the underlying records in order to see whether they are in accordance therewith ;and
- (d) to make a critical review of the Income and Expenditure Account and the Balance Sheet to see that a report may be made stating whether, in the opinion of the auditors, the accounts are presented and the items are described in such a way that they show not only a true but also a fair view.

## **8.02 Certification of Accounts**

### **8.02.01 General**

The certification of annual accounts means verification of the accounts with reference to the books of original entry, ledgers etc., to see that the accounts have been compiled in accordance with the books.

It is not obligatory to certify the annual accounts of the autonomous bodies/ organisations audited under Section 14 of the CAG'S DPC Act. However, certification of annual accounts will be involved in cases where audit is taken up under Section 19 or 20 of the Act. The certification of accounts need not be done in cases where C.& A.G. is not the sole auditor but is doing a superimposed audit under Section 19(3)/20(1) irrespective of the fact whether the primary auditors are appointed on his advice/recommendation or not.

### **8.02.02 Audit Certificate**

Where the audit party feels that the annual accounts of the autonomous body can be certified, an audit certificate in the following form may be issued under the signature of the Principal Accountant General/ Accountant General along with a copy of the annual accounts and a Separate Audit Report (SAR) (para 12.03 of chapter 12 of this manual may be referred to for SAR):

#### **“AUDIT CERTIFICATE”**

I have audited the attached Balance Sheet of-----  
(Please indicate the name of AB) as at 31 March----- (year)  
and the Income and Expenditure Account, Profit and Loss Account/ Receipts and  
Payments Account (strike out which is not applicable) for the year ended on that date.  
These financial statements include the accounts of -----units/ branches (strike out  
if not applicable). Preparation of these financial statements is the responsibility of the  
AB's management. My responsibility is to express an opinion on these financial  
statements based on my audit.

I have conducted my audit in accordance with applicable rules and the auditing  
standards generally accepted in India. These standards require that I plan and perform the

audit to obtain reasonable assurance about whether the financial statement is free from material misstatements. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. I believe that my audit provides a reasonable basis for my opinion.

Based on our audit, I report that:

1. I have obtained all the information and explanation, which to the best of our knowledge and belief were necessary for the purpose of our audit;
2. Subject to the major observations given below and detailed observations in the Separate Audit Report annexed herewith, I report that the Balance Sheet and the Income and Expenditure Account/ Profit and Loss Account/ Receipt and Payment Account/ (strike out which is not applicable) dealt with by this report are properly drawn up and are in agreement with the books of accounts.

(Significant comments)

- .....
- .....
- .....

3. In my opinion and to the best of my information and according to the explanations given to me.
  - (i) the accounts given the information required under the prescribed format of accounts;
  - (ii) the said Balance Sheet, Profit and Loss Account/ Income and Expenditure Account/ Receipts and Payment Account (strike out which is not applicable) read together with the Accounting Policies and Notes thereon, and subject/ due to the significant matters stated above and other matters mentioned in the separate Audit Report annexed herewith, give/do not give (strike out which is not applicable) a true and fair view.
    - a. In so far as it relates to the Balance Sheet of the state of affairs of the AB (Name of AB) as at 31 March.....(year); and

b. In so far as it relates to the Profit and Loss Account/ Income and Expenditure Account (strike out which is not applicable) of the profit/ loss/ surplus/ deficit for the year ended on that date.

**Place:** **Principal Accountant General/Accountant General**

**Date:** **(Audit) Uttarakhand**

(Authority letter No. 44/Rep (AB/91&2003 dated 25<sup>th</sup> April 2006 of Sri A.K. kaushik, Director (Exam/AB) of office of the Comptroller and Auditor General of India New Delhi- 110002).

### **8.02.03 Cases of inability to certify the accounts**

Where the audit party feels that it is undesirable to certify the accounts even subject to observation, the specific points in support of such an opinion must be indicated. Cases where the fundamental correctness of Cash Book is in doubt or where large number of vouchers, receipt books and other supporting documents have not been made available or cases in which basic records have not been maintained or where there are clear indications of misappropriations, fraud or misrepresentation of facts in accounts or accounts as compiled are materially inaccurate requiring revision, etc., would fall in this category. In such a case the audit party must bring the points to the notice of the Chief Executive of the autonomous bodies and also address the head office so as to enable Headquarters to take appropriate action. In all such cases where it is not considered safe to certify the accounts, the office of the Comptroller and Auditor General should also be kept informed of the position indicating the reasons for non-certification of the accounts.

It would, however, not be advisable to take stand that audit certificate would not be issued, if the Government or autonomous bodies insist on such certificate, it is open to audit to certify accounts with observations. In cases where the observations are of such nature as would not warrant certification of accounts as exhibiting true and fair picture, it may be necessary, if so insisted upon by the Organisation or the Government, to issue an

audit certificate in such a case, making it abundantly clear in the certificate that in view of the observations in the Separate Audit Report, the accounts can not be said to exhibit a true and fair picture.

### **8.03 Form of annual accounts**

It has been decided by the Government of India that, except where otherwise specifically authorised, every autonomous body/ organisation that receives financial assistance from Government in the form of grants/ loans, must compile the following three sets of accounts

- (i) Receipts and Payments Accounts,
- (ii) Income and Expenditure Account, and
- (iii) Balance Sheet.

While carrying out the audit of annual accounts, it is necessary to ensure that the accounts indicate in sufficient details, information necessary to give an understanding of the results of working and the financial position of the organisation.

### **8.04 Receipts and Payments Account**

The Receipts and Payments Account is an abstract of cash receipts and payments extracted from the Cash Book including the opening and closing balances. The receipts are entered on the debit side and payments on the credit side. It contains the record of all cash receipts and payments of a particular accounting year whether these receipts and payments pertain to that accounting year or not. This account neither makes any distinction between capital and revenue expenditure nor shows the whole income (including accrued income) and expenditure (including outstanding expenses) for the year under audit.

### **8.05 Income and Expenditure Account**

Since the cash transactions of the Receipts and Payments Account do not make any distinction between capital and revenue and do not enable one to quantify the income and expenditure of revenue nature, pertaining to the period under audit, it is necessary to prepare Income and Expenditure Account which is designed to measure the income for a

given period for the non commercial organisation. Income and Expenditure Account is thus prepared on accrual basis where all the income of revenue nature whether received or not pertaining to the period under audit is taken credit of and the revenue expenditure whether paid or not, relating to the period is charged. Expenditure is shown on the debit (left hand) side and income (receipt) on the credit (right hand) side. The two sides of the account must tally and differences between the two sides of this account representing either excess of income over expenditure or vice versa, are taken to the liabilities or assets side, as the case may be, in the Balance Sheet.

In a number of organisations, due to absence of trained manpower or other reasons, the cash basis of accounting is still being followed. But audit should insist on preparation of the annual accounts on accrual basis. In case of audit of accounts prepared on cash basis, the audit certificate should be qualified accordingly.

## **8.06 Balance Sheet**

Whenever an Income and Expenditure Account is prepared, the Balance sheet must follow to give an understanding of the financial position of an organisation, because Balance Sheet is a statement prepared in order to get the true and fair view of the financial position of an organisation on a certain date. The left hand side of the Balance Sheet is liabilities side which indicates what money has been made available to the organisation and from where? The right hand side called Assets side shows how the organisation has used the money made available to it. Total assets must always be equal to total liabilities to creditors and others.

### **8.06.01 Capital and Revenue expenditure.**

The Balance Sheet comprises items of capital nature. Hence it is essential to have a clear idea of what capital means. Capital by and large, represents cost, the benefit of which does not expire during the period covered by audit, but lasts for a longer income period. Expenditure incurred on the acquisition of permanent assets such as, land, building, plant and machinery, furniture and fixtures, stock etc., is of capital nature. Expenditure incurred on increasing or improving the earning capacity of the existing assets or to reduce the liabilities of the organisation is also capital. A part of the capital expenditure,

which is treated as expired, during the accounting period is charged to revenue of the current period, the balance being carried forward in the balance sheet to future accounting years.

Revenue expenditure consists of expenditure incurred on maintenance of existing assets by way of replacements, repairs and renewals etc., and also the current expenses of establishment and running of the organisation e.g., office salaries, rent, rates, carriages, advertising, depreciation of assets etc.

The principle of distinction between capital and revenue should not be carried to an illogical extremity. It is customary in certain organisations to charge small items of expenditure of capital nature to the revenue of the year in which the expenditure is incurred e.g., library books, furniture etc. It is, however, necessary to disclose such accounting policies in the accounts. In the absence of such disclosure, the Audit Report should disclose the accounting practice followed. The important point to be seen in this connection is that the method is followed consistently, is reasonable as a going concern, and does not result in creation of secret reserves of material amount.

#### **8.06.02          Assets and Liabilities**

There are two main groups of assets; fixed and current. Fixed assets are acquired for long term use in the organisation. They do not vary day to day e.g., land, building, plant and machinery, furniture etc. These assets are valued at cost less accumulated depreciation. However, no depreciation is charged on land. Current assets generally include, cash, debtors, investments etc. They are valued at cost or market value whichever is lower.

Liabilities are also classified as fixed and current liabilities. Fixed liabilities are those which are to be discharged after a very long time e.g., long term loan etc., while current liabilities are such as are to be discharged in the near future e.g., sundry creditors, loans, outstanding expenses etc. There is a third category of liability also known as “Contingent Liabilities”. Contingent liabilities are those in which payment depends only on the occurrence of a particular event, such as, payment of decretal amount in a suit pending in the Court of Law, payment of loan as a surety when the loanee fails to repay it, etc.

The assets and liabilities in the Balance Sheet are shown either in order of liquidity or in order of permanence.

### **8.07 Records for accounts audit**

As all transactions ultimately take the shape of cash outflow or cash inflow, Cash Book constitutes the most important book of original entry. For various adjustments, journal is used. The Cash Book serves both as a book of original entry and also a ledger; ledger accounts are maintained for consolidating various transactions under appropriate classifications. The ledger balances are then listed in a trial balance, from where items of revenue expenditure and income are transferred to Income and Expenditure Account. The remaining items are transferred to the Balance Sheet. Normally, closing stock does not figure in the trial balance.

#### **8.07.01 Check of Trial Balance**

Although trial balance is not a part of the annual accounts for audit, but the checking of the accounts starts from the trial balance. The balances appearing in the trial balance are to be verified from the ledger accounts. The ledger accounts in turn will be checked with reference to the books of original entry like Cash Book and the Journal.

### **8.08 Broad outline for accounts audit**

The audit of annual accounts is based broadly on the following lines

- (i) Entries in the Cash Book and other books of original entries should be vouched and the castings tested.
- (ii) The postings from the books of original entry to the ledger accounts should be test checked.
- (iii) The justification and authority for each journal entry should be examined.
- (iv) The ledger balances should be checked and agreed with schedules, like debtors' schedule and creditors' schedule etc.
- (v) Provisions for outstanding liabilities and accrued income should be verified.
- (vi) The Receipt and Payment account should be checked from the Cash Book.

- (vii) The Income and Expenditure account should be checked with the trial balance.
- (viii) The ownership and continued existence of assets appearing in the Balance Sheet should be verified and adequacy for depreciation and bad debts etc., checked.

### **8.09 Need for vouching of entries**

Mere checking of postings in the books of accounts is no proof that the entries made therein are true and are complete without any omission, unless checked with reference to the information obtained from the original documents from which the books have been written up. This examination is called “vouching”, the salient features of which are mentioned be

- (i) The vouching for payment includes examination of the authority for payment, reconciliation with liabilities discharged or assets acquired, verification of rates, and quantum of payee. Besides, it should also be examined that the payment voucher is addressed to the organisation and relates to the affairs of the organisation, pertains to the period covered by audit and does not bear any sign of having already been used for another payment.
- (ii) Vouching for income aims at ensuring that values for supplies and services have been either received or accounted for as recoverable, that all receipts have been brought to account immediately, that the system of internal control in force does not leave scope for fraud or defalcation.
- (iii) Check of classifications.
- (iv) Checking of journal entries with reference to evidence, authority and narratives.
- (v) The entries in other books of original entries should also be vouched subject to the nature of the organisation and the adequacy of the system of internal control.

## **8.10 Points to be seen in checking the final accounts**

Apart from the necessary routine checking of postings, castings and vouching, the following points should also be seen while conducting the audit of the annual accounts of an autonomous organisation

- (i) check opening balance with the closing balance of the previous year as shown in the balance sheet;
- (ii) examine transactions of exceptional nature which have resulted in-charges or credits of abnormal amounts during the accounting period as compared to the previous year;
- (iii) all capital expenditures to be vouched as per instructions contained in para 8.09 of this chapter;
- (iv) verify the existence, possession and ownership of assets and check basis of valuation and provision for depreciation also (refer para 5.09 of this Manual); the valuation of current assets need be considered in particular;
- (v) ascertain the system of stock taking, test check stock sheets and valuation, and obtain certificate of physical verification of the stock from responsible officials;

(Note:- In the case of organisations which do not earn revenue of their own, it has been decided that no depreciation need be written off till the assets exhaust their useful life or till they are disposed of).

- (vi) examine the bank reconciliation statement critically, analysing the reasons for difference between the bank balance as per Cash Book and pass book, and verify the certificate obtained from the banks;
- (vii) check the classification of capital and revenue expenditure as per provisions given in Para 8.06.02;
- (viii) ensure adequacy or otherwise of provisions for outstanding liabilities, bad and doubtful debts, damage or deterioration in value of fixed and current assets;

- (ix) make sure that all income has been brought to account;
- (x) see that all allowances, discounts, etc., are authorised and admissible;
- (xi) examine carefully commitments for capital expenditure not provided in the accounts and ensure that ascertained liabilities are not shown as contingent liabilities (for contingent liabilities refer to para 8.06.02);
- (xii) review sundry debtors (persons who have received the goods/services but have not paid for them), outstanding advances, etc., analyse reasons for their pendency and ensure their recovery with a view to see that none of them represents fictitious balance;
- (xiii) compare important items in the Income and Expenditure Account with corresponding items of the previous year and ascertain and analyse the reasons for significant variation; shortfall in income from a particular source should be examined in depth;
- (xiv) similarly, compare the current Balance Sheet figures with the previous Balance Sheet figures to determine material changes after examining the schedules showing the composition of each item, reasons for the changes need be analysed critically;
- (xv) comment on unproductive assets created or expenditure incurred during the year under audit;
- (xvi) examine particularly the expenditure incurred on items which qualify for grants/ assistance to ensure that no attempt is made to secure inflated grant/assistance from the Government;
- (xvii) analyse if any change has been made on the basis of accounting having material effect on the accounts of the year under audit;
- (xviii) look for and comment on the charges, transactions which do not fall within the scope of authorised activities of the organisation;
- (xix) in case the annual accounts of an autonomous body are prepared after consolidating the accounts of all its' units, it should be verified that the

annual accounts finally compiled do not omit any account of any unit. To ensure that the relevant details and subsidiary records pertaining to the accounts have been maintained properly, a certificate to this effect should invariably be obtained from some responsible functionary of the unit;

- (xx) examine that fixed assets e.g. plant, machinery and library books etc., if received by any autonomous body as gift (free of cost), are included in the respective asset and corresponding entry on the liability side of the Balance Sheet is made under this head, “Capitalised value of gifted assets”; and
- (xxi) transactions shown under “Suspense Account” should be examined in depth and details of the items and reasons for keeping them under “Suspense” analysed and action proposed to be taken for their early clearance ascertained, making a suitable comment in the audit inspection report of the unit concerned.

## **CHAPTER-9**

### ***ORGANISATIONS COMING UP FOR AUDIT UNDER SECTION 14 OF THE AUDIT ACT***

#### **9.01 Categories of Organisations**

The autonomous bodies may fall under the following categories

- (i) Commercial, Public Utility and Promotional undertakings established under Acts of Parliament or State Legislatures.
- (ii) Bodies and authorities established for educational, cultural, scientific or social welfare development.
- (iii) Authorities and corporations constituted by Acts of Legislature for development of urban and rural areas.
- (iv) Consumer and producer co-operatives, which receive substantial assistance from Government.

A list of units as on 01-04-2014 being audited under Section 14 is given in **Annexure- 9**

#### **9.02 Financial and Operational Auditing**

The duties of audit in respect of these organisations can broadly be grouped into two categories

- (i) Financial auditing and (ii) operational auditing. Financial auditing is a critical review of the central and financial records of an organisation to ensure accuracy and fairness of the financial statements and adequacy of the safeguards available against errors and losses. This task is performed by the auditor certifying the annual accounts. The procedure of financial audit as indicated in Chapter-5 will apply mutatis mutandis for audit under Section 14. Operational auditing is intended to go beyond the financial audit already conducted by other auditors. It may be termed as management auditing. Thus, audit under Section 14 is a second audit for an objective entirely different from the one for which the organisation had appointed auditors for annual certification of accounts.

### **9.03 Review of programmes and their implementation.**

As second auditor, the function of the Comptroller and Auditor General is not merely to see that the accounts represent a true and fair picture of the transactions of the year, but also to examine whether value for money spent has been realised. Audit under Section 14 will include a review and appraisal of the efficiency and effectiveness of the programmes and their implementation procedures. The audit will discover the problems of implementation and consequential failure and shortcomings in the implementation of the programmes and policies.

### **9.04 Periodicity of Audit**

The results of audit, as stated above, has to be reported to the Parliament /Legislature, but an in-depth analysis cannot be conducted every year and it cannot find a place in the Audit Report each year. An annual presentation under Section 14 could mean a repetition of points without the objective of audit is taken up once in a period of 3-4 years for each organisation.

### **9.05 Points for scrutiny**

With reference to the objectives mentioned in Para 9.04 above it should be seen that

- (i) the objectives of the organisation are in conformity with the Government's policies and decisions and also as stated in the Memorandum of Association or other Charter establishing the organisation;
- (ii) policies and programmes are drawn up in accordance with the objectives stated there in and are being implemented by specific and well defined procedures;
- (iii) procedures are followed as intended;
- (iv) system exists for collection of reliable progress reports on implementation of policies and programmes;
- (v) progress is, from time to time, reported to the Governing Body of the organisation/ Government; and

- (vi) an effective control exist over various areas of implementation to check leakage, loss, avoidable and wasteful expenditure etc.

### **9.06 Analysis of activities**

With a view to conducting effective and purposeful audit of the organisations falling under the purview of Section 14, the audit parties must be familiar with the various aspects of the organizations. The activities of the organisations can be analysed under the following headings

- (i) organisational set up;
- (ii) management process;
- (iii) research and development;
- (iv) personnel policies and management;
- (v) materials management;
- (vi) finance, accounts and audit; and
- (vii) works;

Before taking up audit of an organisation, the audit parties should go through the departmental manual with a view to make themselves conversant with organizational set up, various activities and objectives of the organisation.

### **9.07 Audit of important organisations**

The example of DRDA organisation is given below

#### **9.07.01 District Rural Development Agencies (DRDA)**

- (A) The agencies are registered societies under the Registration of Societies Act, 1860. They are generally headed by the Collector/ Deputy Commissioner or Chief Executive Officer, Zila Parishad depending upon the practice prevailing in the State. The Project Director is the Head of office of the DRDA at district level to look after procedures for implementation of the programme, release of funds, preparation of annual accounts etc.

## **(B) Objective of the programme**

The objective of the programme is to assist the families identified below the poverty line in rural areas to enable them to cross this line by taking up self employment ventures. For this purpose various development programmes have been placed under the charge of DRDA e.g., Indira Awas Yojna, Swarn Jayanti Gram Swarajgar Yojna, Pradhan Mantri Gramin Awas Yojna, Vidhayak kshetra Vikas Nidhi, Sansadiya kshetra Vikas Nidhi. Prime Minister of India announced on 15<sup>th</sup> August 2001 an ambitious scheme called Sampoorna Gramin Rojgar Yojana (SGRY) by merging Employment Assurance Scheme (the only additional wage employment scheme for rural areas) and Jawahar Gram Samridhi Yojna( a rural infrastructure development scheme) into one scheme which was launched with effect from 25<sup>th</sup> September 2001.

The programme aims to achieve the stated objective by providing income generating assets including working capital, where necessary, to the target group families through package of assistance comprising subsidy and institutional credit.

## **(C) Poverty Line**

Poverty line has been defined in terms of annual income of a family. A family having an annual income below the ceiling fixed by Government, from time to time is considered to be family below poverty line. The assistance will be given on priority basis as per direction of the Government.

## **(D) Funds**

The Sampoorna Gramin Rojgar Yojna is a centrally sponsored scheme funded by both the Centre and the State.

The funds are released to DRDA on the following principles

- (i) that the expenditure should be shared by the Centre and the State in the ratio 75:25 respectively;
- (ii) that the expenditure should not be repugnant to the objective and the needs of the programme.

### **(E) Functions of the DRDAs**

The DRDAs are the overall in-charge of the planning, implementation, monitoring and evaluation of the programme in the district. The functions of the agencies are as under

- (a) To keep the district level and block level agencies informed of the basic parameters, the requirements of the programme, of the task to be performed.
- (b) To co-ordinate and oversee the surveys, preparation of perspective plans, and Annual Action Plans of the blocks and finally prepare a District Plan.
- (c) To evaluate and monitor the programme to ensure its effectiveness.
- (d) To secure inter Sectional and inter-departmental co- ordination and co-operation.
- (e) To give publicity to the achievements made under the programme.
- (f) To send periodical returns to the State Government in the prescribed formats.

### **(F) Maintenance of Accounts**

Since the DRDAs are registered societies, the accounts of the agencies are maintained on double entry system.

### **(G) Follow-up, Monitoring and Evaluation**

#### **Follow up**

The follow-up of projects given to the beneficiaries should be done through the instrument of the Vikas Patrika. Two copies of this document should be prepared of which one copy should be given to the beneficiary family and the other should be kept at the block Headquarters. The copy of block Headquarters should be kept upto date about the availability and the health of the project. An annual physical verification of assets may be undertaken on a campaign basis at the end of every year. The results of such verification should be incorporated in the Annual Action Plan of the next year.

## **Monitoring**

The performance report is to be sent by the DRDA in monthly, quarterly and yearly proforma. The States will send the information received from the DRDAs to the Centre.

## **Evaluation**

The state may give evaluation studies subject to the condition that the expenditure per DRDA per year is not more than the amount fixed by the Government from time to time. The proposals for the evaluation studies by the DRDAs would be considered and cleared by the state level co-ordination committee.

### **(H) Audit of the Accounts**

The Project Director should cause the annual accounts of the agency to be prepared by a date not later than 30<sup>th</sup> June comprising of a Receipt and Payment Account, Income and Expenditure Account and Balance Sheet. After approval by the Governing Body, he shall have the accounts audited by the Chartered Accountant or any other auditor appointed for the purpose.

A copy of such audit report along with the annual statement of accounts certified by the auditor and the chairman of the agency thereon should be furnished simultaneously to Government of India and the State Government not later than 30<sup>th</sup> September.

The C& AG has the right to conduct audit of the accounts of the society and shall have right of access to the books of accounts and other relevant records of the society. For this purpose a copy of the annual accounts along with the Audit Report and comments of the agency thereon, shall be sent to this office, the audit office nominated by the C& AG.

A statement showing the schedule of Fixed Assets held by the agency at the end of the financial year should be sent to the State Government and the Government of India in the form prescribed along with the annual statement of accounts. No depreciation should be charged and value of assets to be shown at the original cost in the accounts.

All the agencies should send a utilisation certificate to the Government of India (Department of Rural Development) in the prescribed proforma alongwith the annual statement of accounts.

Besides the audit of activities of the District Rural Development Agency in respect of organisational set up, management process, personnel policies, finance, accounts and audit, the audit parties will have to study the materials on the schemes taken up by the Agency during the period of audit i.e., Sampoorna Gramin Rojgar Yojna, Sampoorna Gramin Swarojgar Yojna etc.

In this connection the Manual of Sampoorna Gramin Swarojgar Yojna may also be referred to for detailed study.

Some significant points which should be examined by the audit party in detail are given below by way of an illustration.

### **1. Financial Performance**

- (i) Funds received during the period of audit, amount utilised and the unspent balance should be worked out.
- (ii) Investment of amounts in Bank, Post office or National savings scheme should be investigated and commented upon.
- (iii) Funds, advanced to executing agencies for works under different schemes, and treated as expenditure in the books of the DRDA, should be worked out. The manner, in which the utilisation of advance by the recipient agencies was watched, should be examined.

### **2. Annual Action Plan**

A shelf of projects is to be prepared by each DRDA for works to be undertaken in the district taking into account the needs of the rural community. On the basis of such shelf of project, an annual action plan is to be prepared at the start of the financial year. The non preparation of shelf of projects/ annual action plan should be commented upon

### **3. Annual Statement of Accounts**

Non-observance of the accounting procedure and non-maintenance of the multi-column Cash Book, Ledger, Journal etc., result in lack of effective control over the utilisation of funds allocated and fulfillment of objectives.

#### **4. Non-reconciliation of Bank/ PLA balances**

Non-reconciliation of the ledger balances with balance in PLA should be commented upon.

#### **5. Assets and their physical verification**

A register of assets is required to be maintained and result of annual physical verification with the beneficiaries' files is to be made available to audit. A quarterly report on the results of physical verification is required to be sent to Government.

Non-maintenance of these records denotes that the DRDA did not have adequate information of utilisation of the subsidy.

#### **6. Utilisation Certificates**

The DRDA should send utilisation certificate to State Government to the effect that the funds were utilised for the purpose for which they were sanctioned and the objectives were fulfilled.

The amount of grant, in respect of which utilisation certificate was not sent, may be taken in a paragraph.

#### **7. Mis-utilisation of Grants**

The grant, given to beneficiaries to acquire such assets that would raise their earning capacity and enable them to rise above poverty line, is to be examined and its physical verification report is to be seen to ascertain whether the beneficiaries were in possession of the assets. If not, it is clear that either the funds were mis-utilised or the assets created were sold out.

In either case the entire amount is recoverable from them as land revenue. Steps taken in this direction may be investigated and the matter included in a paragraph.

#### **8. Non-remittance of sale proceeds by the forest department**

DRDA advances money to Forest Department for social forestry and the sale proceeds of the plants are remitted in turn to DRDA. It was observed during the period of audit that

sale proceeds were not credited by the Forest Department to DRDA accounts, but kept under forest deposit.

The non-maintenance of any record by the DRDA to show outstanding dues from the Forest Department on account of sale proceeds may be commented upon.

#### **9. Recovery of subsidy from Harijan Kalyan Department under Special Component Plan**

Subsidy for economic activity to the extent of 50 percent of the total amount is admissible to the members of SC/ST communities. Of this, an amount equal to 16-2/3 percent is recoverable from the Harijan Kalyan Department. As per existing procedure, the Harijan Kalyan Department advances money to the DRDA for payment of their share of subsidy and the latter is required to send quarterly statement of adjustment to the former. Records concerning recovery of amount due from Harijan Kalyan Department and adjustment of advances made by that department may be verified and commented.

#### **10. Non-generation of employment**

The State Government allots foodgrains to DRDA, which in turn allots them to various executing agencies such as PWD, RES, Forest, Zila Parishad, Irrigation, etc, for (generation of employments) making payment to labourers partly in the form of foodgrains.

Non-lifting of food grains results in lesser generation of employment. Its value may be worked out and commented upon.

Similar comments on non-utilisation of grants received for Sukha Rahat Scheme may be made.

#### **11. Monitoring**

Monitoring cells were to be created at both the levels i.e., State Level and DRDA level to ensure proper implementation of the various programmes and their evaluation. Follow up action is to be taken on the shortcomings noticed during the process.

Non-creation of cell and non-evaluation of the programmes may be commented upon.

## **12. Other Topics**

- (i) Purchases of materials of higher quality than sanctioned by the State Government and expenditure incurred thereon may be commented upon as extra expenditure.
- (ii) Similarly, purchase of car instead of jeep as sanctioned by the State Government may be pointed out.
- (iii) The DRDA is required to ensure return of empty gunny bags used for supply of food grains by implementing agencies and to utilise funds thus realised to supplement various programme. The value of gunny bags, not returned by the implementing agencies, may be worked out and included in the AIR.
- (iv) Diversion of funds of a scheme to other schemes/programmes or utilization of funds on schemes other than the intended ones. ( specific amounts may be mentioned in each case )
- (v) Cases of incomplete/ abandoned works may be cited with full details, viz., amount sanctioned, target date of completion, date of commencement, amount spent (till date of audit), reasons for incompleteness/ abandonment etc.

### **9.07.02 Audit of Bhoomi Sanrakshan Adhikari of Command areas.**

The Audit of Bhoomi Sanrakshan Adhikari of Command Areas needs to be audited under Section 14. The Inspecting Officer/Asstt. Audit officer must prepare and forward Inspection Reports to Headquarters. On receipt of these reports editing Section of Social Sector will edit, issue and pursue the Inspection Reports and keep it in their record also.

## **CHAPTER-10**

### ***AUDIT UNDER SECTION 15***

#### **10.01 General**

Section 15 of the Audit Act, 1971 has two sub-Sections. Under sub-Section (i) it is the statutory responsibility of audit to scrutinise the procedure by which the sanctioning authority satisfies itself as to the fulfillment of the prescribed conditions of the grant and loan. Under sub-Section (2) audit has the right to scrutinise the records of the grant receiving body subject to certain specified limitations.

#### **10.02 Approach of audit**

Since the emphasis of audit under this Section is on scrutiny of procedure, the approach of audit should be system based, as distinct from transaction audit. The first step would be to see whether adequate rules and regulations have been framed by the sanctioning authority/ Government for ensuring that the objective of giving the assistance is achieved. The rules and regulations should cover aspects like verification of antecedents and the capability of the grant receiving authorities to implement the programme with efficiency and economy. It should also provide adequate checks and balance in the system to get timely feed back of the progress of the job expected to be done with the assistance.

In the course of system audit, it would be the duty of auditors to examine if the rules and regulations themselves require any change with reference to existing situation.

The scrutiny of procedure implies examination of the adequacy of prescribed returns and reports from the grant receiving authorities. The auditor will critically examine whether the existing system of reporting ensures adequate and constant watch of the sanctioning authority over the grant receiving institutions regarding proper utilisation of the assistance given.

The system audit consists of scrutiny of individual cases to form an opinion on the efficacy of system. It is only then that the weakness or deficiencies in the system could be pointed out.

### **10.03. Scrutiny of accounts**

The scrutiny of the books of accounts of the autonomous bodies is the second part of audit. But the books of accounts of the autonomous bodies may not be examined unless they are audited and certified.

The deficiencies in arrangement should be commented upon and placed in Audit Report.

### **10.04 Audit Checks**

During audit the following points should be kept in mind

- (1) Whether the sanctioning authority has prescribed procedures for satisfying itself that the grants and loans are being utilised for the purposes for which they were given? Such procedures may provide submission of periodic progress reports; submission of audited statements of accounts, and inspection of the grantee institutions.
- (2) Whether the conditions of grants and loans are being fulfilled?
- (3) Whether the returns received from the autonomous bodies are being reviewed and proper action taken?
- (4) Whether irregularities noticed during inspection or scrutiny of records are being removed and action taken where necessary?
- (5) Whether the registers of grants and loans are maintained in prescribed forms, properly posted and reviewed at appropriate levels?
- (6) Whether a register of assets, created out of Government grants, is maintained and it is ensured that the assets are put to use for intended purposes?
- (7) Whether any action is taken in the cases of diversion of use of assets or their sales?
- (8) Whether any action is taken in cases where utilisation certificates are not received?
- (9) Whether the excess of grant/ loan is worked out and recovered?

- (10) Whether any legal action is taken against defaulting grantees and whether the payment of subsequent grants is stopped to defaulters?
- (11) Whether the position of recovery of loans is watched and whether the control over it is adequate?
- (12) Whether fulfillment of general objective of a scheme is ascertained?
- (13) Whether a system of obtaining performance/achievement reports exists? If so, whether a scrutiny there of is done?
- (14) Whether defects in the scheme or the sanction itself exist? If so, the same may be commented upon.

#### **10.05. Reporting Results of Audit**

Section 15 does not specifically provide for reporting the results of audit of loans/ grants for specific purpose in the Audit Report. Important irregularities noticed in the scrutiny of procedures should be commented in a report, replies obtained and paragraphs processed for the Audit Report.

#### **10.06 Audits under Section 15(2)**

Under this sub Section audit has got an evaluating right to scrutinise the records of the grant receiving body subject to certain specific limitations. Several autonomous bodies like Nagar Palikas, Universities, Co-Operative Societies etc., whose accounts are audited by primary auditors for which access to their records is not available, fall under this category. In all such cases, a system should be established in consultation with the Government, whereby the copies of audited accounts and audit reports are made available to audit for their critical scrutiny, so as to call out points, which have relevance to the utilisation of grants, loans etc., and to watch follow up action taken by the sanctioning authorities with reference to the reports. The results of such scrutiny can be suitably processed by the Section dealing with audit of sanctioning authority for mention in the Audit Report.

#### **10.07 Pursuance of audit findings**

The results of audit of the books and accounts of the autonomous bodies receiving specific purpose grants/ loans should be pursued with the sanctioning authorities and/ or their superior officers and Government and not with the autonomous bodies directly. The facts, however, will have to be got confirmed by the autonomous bodies.

