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## **INVITATION FOR ARTICLES**

The Indian Journal of Public Audit and Accountability welcomes original articles of professional interest. The articles should broadly cover aspects relating to Public Accountability, Financial Management, Accounts, Audit, Public Administration with focus on Good Governance.

Ideally the article should be between 3000 and 3500 words and should not normally exceed 5000 words. Short articles on topical interest are also welcome which can be included in Commentary Section of the Journal. They should preferably be between 1000 and 2000 words.

Two printed copies of the articles should be submitted along with a soft copy in a word processing format. Articles can also be sent by e-mail followed by hard copy by post.

Articles in Hindi are also welcome, which will be published in original. They should preferably be in simple spoken Hindustani language format. An abstract of the article in about 100 words should also be sent.

## **EDITORIAL**

The current practice of increased transfer of funds to extra Government agencies through direct transfer without routing them through State Government budget has posed a big challenge to the Government accounting system and also, in many ways, to the accountability structure of the Government. Dharam Vir has critically analyzed the various important issues on this subject and concludes that this practice is to be assessed carefully against the potential for accountability deficit created thereby. He also suggests that there is a need for a new architecture of public financial management and accountability. Also, in this context, he feels it is necessary to revisit the issue of CAG's mandate both in regard to his jurisdiction and right to access records to fulfill enlarged mandate.

K.P. Sasidharan's article explains the recent important decisions of the CAG to combat the challenges emerging from corporate governance failures. The article has laid out comprehensively these challenges and described the substantive qualitative transformation in the audit process and methodology by recently introduced system of three phased audit which aims at more intensified, innovative, focused and result oriented approach to financial audit. It also touches on the necessity of greater coordination amongst various regulatory authorities in the corporate arena for better results.

Promotion of Public Private Partnership (PPP) projects is currently the most popular and exciting development and Government of India's encouragement for such projects in the development of physical and social infrastructure is too well known. PPP is new formal institutional mechanism for financing the infrastructure projects to get over the funding problems in development of physical and social infrastructure. Dr. Pandey's article highlights the imperatives driving this concept, general issues faced by Governments in the implementation of PPP projects, scope and practice of PPP in the Indian context and such issues as are of particular concern to Audit.

B.M. Oza has, in the 'book section' reviewed a book published about a year ago by CAG titled "The Comptroller and Auditor General of India – the Thematic History

1990-2007” by Vijay Kumar. This book updates the previous volume on the history of audit department that was published in 1989 by the CAG and written by Shri R.K. Chandrasekharan.

This issue includes a summary of output of a Round Table Conference held by the Institute of Public Auditors of India on the subject “Outcome Budget” and of a seminar on “Governance and Accountability” held by our Tamil Nadu Chapter. These are reproduced here for the sake of wider dissemination. Finally, in our document section this time we are reproducing suitable excerpts from the reports of the Second Administrative Reforms Commission on India’s Financial Management System. As is known, this is likely to be the agenda for the financial reforms by the Government.

We do hope our readers will enjoy the volume and at the same time will also get motivated to contribute articles to the journal for its future editions.

**Disclaimer:**

The views and opinions expressed in the articles are entirely those of the contributors and do not reflect the official policy of the Institute.

# **Implementation of Central Schemes Need for Reforms in the Architecture of Public Financial Management and Accountability**

*Dharam Vir\**

## **Introduction**

Recent years have witnessed a paradigm shift in Government's strategy for implementation of centrally sponsored schemes that assigns a larger role to extra-Government entities for programme delivery in place of Government departments and offices. While in some cases non-Government organizations have been involved by way of public-private partnership, in other cases special purpose vehicles have been set up for programme delivery at the State and/or district level. Some of the schemes are being implemented through Urban Local Bodies and Panchayati Raj Institutions.

Also, Central funds are being increasingly transferred direct to such extra-Government entities and credited to their bank accounts without the intermediation of State Governments. Consequently, neither the amount of such assistance nor the expenditure incurred shows up in the budgets and accounts of the State Governments.

## **Advantages of direct transfer of funds to the implementing agencies**

The direct transfer of the Central funds to the implementing agencies bypassing the State Governments delays the fund flow process and thereby cuts down delays in reaching funds to them and also ring-fences the Central money against possible diversion for other purposes as has happened in the past not too infrequently.

Additionally, it eliminates the necessity of obtaining legislative approval twice over; once from the Union Parliament and second time from the State legislature which is a prerequisite for spending when the Central funds are routed through the State Governments and their budgets. Also, it reduces the incidence of supplementary grants at the State level, since under the system of routing of Central assistance through the State Governments, information about Central funds is not always available in time for the construction of the annual State budget, which therefore remains incomplete to that extent, marred by uncertainty and requires to be augmented by subsequent supplementary grant.

## **Implications for accounting and accountability deficit**

But the flip side is the proper determination and accounting of expenditure actually incurred and the potential for accountability deficit created thereby that challenges the existing system of public financial management and accountability.

According to a recent report of the Comptroller Auditor General of India<sup>1</sup> ([CAG](#)), Union Government expenditure on some of the centrally sponsored schemes of health,

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\* The author is a former Deputy Comptroller and Auditor General of India

<sup>1</sup> Report No.CA 13 of 2009 Accounts of the Union Government

education, poverty alleviation etc for 2007-08 was over-stated to the extent of the unspent amounts lying in the bank accounts of extra-Government agencies to which a staggering amount of Rs.51260 crore had been transferred. The exact amount of the unspent balance in the bank accounts of the transferee agencies and consequently the extent of overstatement of expenditure could not be ascertained.

The overstatement of expenditure and the indeterminateness of its extent are inherent in the currently prescribed accounting policies that equate any outflow from the Government account with expenditure irrespective of its actual spending. Thus Central funds released to the State Governments and extra-Government agencies are traditionally defined as final payments and immediately charged off in Government accounts as expenditure; thereafter further trail ceases to be available in the Central Government accounts. Consequently, what shows up in Central Government accounts is only 'virtual' expenditure as distinguished from actual spending.

Although Government general financial rules and scheme-specific instructions require the recipient agencies to render periodic reports of expenditure incurred by them, the information so reported is not captured in Central Government accounts. There are also instances of delays and defaults in rendering the prescribed reports besides inaccurate and inflated reporting.

The position gets further complicated if the immediate recipient of Government funds passes on the amount to other agencies for actual spending. This happens in the case of amounts initially paid to State Governments or large Mother Non-Government Organizations which in turn engage the services of smaller NGOs for programme delivery. In such a scenario large amounts may remain unspent with the sub-grantees and even the so called 'expenditure' reported by the original recipient may not reflect the amount actually spent.

Also, Government rules and instructions allow a period of one year within which the recipient institution must furnish a certificate of utilization of the assistance provided to it. Accordingly, for any amount of assistance released during 2007-08, the certificate of utilization would be due only by March 2009. In the circumstances what shows up in Government accounts for 2007-08 is nothing more than the outflow of money from Central Government coffers without an assurance of its having been actually spent for the specified purpose(s).

### **Fund flow under the National Rural Employment Guarantee Scheme**

Further, some time the scheme configurations are such that at any time sizeable amounts of Central funds must remain in the pipeline. For example, the overstatement of expenditure in Central Government accounts is built into the very design of the National Rural Employment Guarantee Scheme, which is one of the premier flagship schemes of the Central Government. Under the scheme the Central Government has established a fund called the National Rural Employment Guarantee Fund from which grants are released directly to the Districts and revolving funds are set up at the District, Block and Gram Panchayat levels, with separate bank accounts being opened for such funds at each level. After utilizing 60 per cent of the earlier funds, the District Panchayat Coordinator may apply for the next installment; similarly the Programme Officer will be eligible for the next installment after utilizing 60 per cent of the funds already available; and likewise the Gram Panchayat may apply for release of additional funds after utilizing sixty per cent of the funds already provided. In such a



scenario, the possibility of sizeable amounts of Central funds remaining in the pipeline with one or the other agency is inherent in the very configuration of the scheme and the fund flow drill prescribed therein. This is also borne out by the unspent amount of Rs.90~~8360~~ crore as of March 2009 out of the total funds available amounting to Rs.362~~6338~~ crore for the scheme for the year 2008-09. The amount of Rs.271~~8074~~ crore stated to have been actually utilized is neither verifiable nor part of Government accounts<sup>2</sup>.

### **Fund flow under the Sarva Shiksha Abhiyan**

In the case of another flagship scheme of the Union Government viz. the Sarva Shiksha Abhiyan, Central funds are to be released in two installments; in April and September. But for a variety of reasons, the prescribed calendar is rarely adhered to, and in several cases, the second installment is released only in the month of March. Consequently, large amounts are bound to remain unspent with the implementing agencies when the financial year closes, although in the books of the Union Government, the amounts released in March would have appeared as expenditure.

### **Effect on financial marksmanship and Parliament's financial oversight**

A direct consequence of the dichotomy between outflows and expenditure is the vitiation of executive's financial marksmanship and the Parliament's oversight over Government expenditure. The budget documents for the ensuing year also state the revised estimate for the current year and the actual expenditure for the year before. Both the latter sets of figures are rendered suspect because of the unspent amounts with the executing agencies. Further, cases of deficient or poor financial marksmanship like those involving excess supplementary grants, when the actual expenditure does not reach even the level of original budget provision or unspent budget provisions of Rs. 100 crore and more are specifically commented in the Audit Report and the Ministries are required to explain these to the Public Accounts Committee with detailed explanatory notes. Such comments may not capture the entire gamut of cases of poor or deficient financial marksmanship because of the amounts lying unspent with the agencies which have ~~been eben~~ charged off as expenditure. This further weakens the Parliament's financial oversight over the executive.

### **Effect on output/outcome budget**

Another consequence of the dichotomy between the outflow and expenditure is the effect on performance budget. While the concept and practice of performance budget has been with us since 1969 in the wake of the report of the (First) Administrative Reforms Commission, it received a major fillip in the Government's fiscal policy statement presented with the budget 2004-05. 'Outlays do not necessarily mean outputs and outcomes', said the policy statement. In pursuance of this the Ministries are required to prepare an outcome budget for the current year and a performance

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<sup>2</sup> Information as per the NREGA website; the amounts include both the Central and the State Government funds. Also, as pointed out in CAG's Audit Report No. PA 11 2008, there may be numerous cases of overstatements of utilization of funds.

budget for the previous year for the purpose of correlating spending with outputs and outcomes. But when the amount of actual spending is not known and remains indeterminate, there can be no worthwhile correlation between the amount spent and the outputs and outcomes achieved. The outcome and performance budgets are thus rendered approximations which can hardly serve the intended purpose.

### **Effect on classification of expenditure between capital and revenue**

Incidentally, a further consequence of increased reliance on the extra-Government agencies for programme delivery and the direct release of Central funds to them is the possibility of distorted presentation of accounts that may result in understatement of capital expenditure. Under the rules any significant amount of expenditure incurred with the object of acquiring tangible assets of a permanent nature or enhancing the utility of existing assets shall be broadly classified as capital expenditure. But the classification of expenditure is not affected by its ultimate end use and it is the eventual ownership of the asset created thereby that determines the manner of its exhibition in accounts. Thus while the expenditure incurred by Government for construction of a school building is classified as capital expenditure, the same amount paid to an extra-Government agency (State Implementing Society) for the same purpose would show up as revenue expenditure in the books of the Central Government. Consequently, the capital expenditure is understated to the extent funds are released to the extra-Government agencies for works of a capital nature<sup>3</sup>.

### **Need for reforms in accounting policies, systems, reporting etc**

Expenditure tracking has been always problematic even when funds are routed to the executing agencies through the State Governments since Central funds may remain in the State Governments' Public Account or kept by them in bank deposits but it has assumed a qualitatively different dimension, when according to one estimate nearly 85 per cent of the Central funds are being remitted to the extra-Government agencies in respect of some of the major schemes. The current system was devised to meet the requirements of a different management milieu, when the bulk of expenditure was incurred through Government departments with only a marginal role for extra-Government agencies. The paradigm shift in the instrumentalities of programme delivery and the manner of release of Central funds to the implementing agencies without the intermediation of the State Governments and the enlarged role assigned to the extra-Government agencies need to be matched by corresponding reforms in accounting policies, systems, processes and reporting that clearly differentiate between outflow/release and expenditure and separately disclose both.

The issue was flagged in the Government's Economic Survey 2007-08 as follows:

“An increasing proportion of fund transfers to the States in recent years take place under CSS. These funds are routed to States and district level bodies directly from the Central Government. The practice is motivated by the desire to avoid delays and to

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<sup>3</sup> An Expert Group constituted by the Government of India under the Chairmanship of Dr. Ashok Lahiri to Review the Classification System for Government Transactions (2004) had recommended that such transfers as are meant for capital expenditure by the transferee may be classified as Capital Grants in the Revenue Section of the books of the transferor. Also, although an enabling provision in the General Financial Rules permits classification of expenditure on account of grants-in-aid as capital expenditure on the advice of the CAG, this does not seem to have been invoked.

prevent diversion of CSS funds by the States to support their ways and means position. Of late the emerging concern is ensuring accountability on the usage of funds.

The existing system of accounting for plan schemes does not adequately support informed planning, budgeting, effective monitoring, and decision making. The current accounting system does not capture transaction-oriented information. It does not distinguish between transfer to States, final expenditure, and advance payments against which accounts have to be rendered. The extant accounting framework is not structured to generate State-wise and scheme-wise releases of funds by the Central Government to States, and other recipients and also the actual utilization for the intended performance.

There is need to devise and implement a scheme aimed at reforming this process..... Such a scheme would be finalized during the Eleventh Five Year Plan.”

The (Second) Administrative Reforms Commission has devoted one complete chapter of its Fourteenth Report on Strengthening of Financial Management Systems to the issue but does not appear to have come out with a solution. After describing the outlines of an IT-enabled system (based on a paper<sup>4</sup> provided to it) that would (i) provide a platform for consolidating accounting data relating to all plan schemes on a uniform basis, irrespective of the agency that is actually charged with the receipt of funds and programme implementation; and (ii) ensure that the expenditure is booked in accounts of the Union Government only at the time when the actual payment in the field takes place, the Commission has made the following recommendation:

“The Controller General of Accounts, in consultation with the CAG should lay down the principles for implementing the system of flows of sanctions/approvals from the Union Ministries/Departments to the implementing agencies in the States to facilitate release of funds at the time of payment. After taking into account the available technology and infrastructure for electronic flow of information of funds, especially under the National e\_Governance Plan, and putting in place a new Chart of Accounts, the scheme should be implemented in a time-bound manner.”

According to the information available on the CGA’s website, the CGA is currently working on a Plan Accounting and Public Finance Accounting Scheme (jointly overseen with the CAG) that would capture data on sub-sanctions going progressively down the line right up to the implementing agencies and expenditure details from such agencies.

### **A suggested short term measure**

This will take time to work out. However, as a short term interim measure a system, limited to the flagship big ticket schemes, can be devised on the following lines. The amount released by the Union Government may be initially accounted under a suspense head within the Consolidated Fund under the relevant major head of accounts. The amount kept under suspense should be cleared by debit to the service head and contra minus debit to the suspense head on receipt of statement of expenditure from the implementing agency. Such a statement should be duly audited by the CGA’s organization in accordance with the procedure currently prescribed in

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<sup>4</sup> Development of a Management Information & Decision Support System for Plan Schemes by Archana Nigam and Dipankar Sengupta

respect of audit of expenditure met from World Bank assistance. with such test audit as the IAAD may decide in its discretion. The system will ensure that while the Consolidated Fund is debited as soon as the Central assistance is released, the expenditure is booked to the scheme only on receipt of confirmation of its actual spending. The amount under suspense will exhibit the amounts still in the pipeline at any time.

The above suggestion can be fine tuned and tried for one or two schemes to begin with.

### **Other implications of direct transfers**

Both the Economic Survey and the Second Administrative Reforms Commission seem to have viewed the implications of the disintermediation of State Governments in the fund flow for the Centrally Sponsored Schemes from the perspective of the Union Government only. But there are other wider issues as well.

### **Effect on State Government budgets**

First is the issue of the effect of the disintermediation of State Governments on the transparency and comprehensiveness of State Government budgets. Some of the Centrally Sponsored Schemes do not fall within the subjects allocated to the Union Government in List I of the Seventh Schedule to the Constitution. These deal with subjects that are included in List II of the Seventh Schedule i.e. the State List<sup>5</sup>. Accordingly, the State budgets (and accounts) are the most appropriate vehicle of disclosure of the extent of Government interventions in the areas that are funded through the Centrally Sponsored Schemes. But what appears in the State Budget is only the expenditure provided/met from the State funds. This can be a very small percentage of the total expenditure mere miniscule as for example in the case of the National Rural Employment Guarantee Scheme for which the State Government bears only 25 per cent of the cost of materials and wages of skilled and semi-skilled workers; unemployment allowance and the administrative expenses of the State Employment Guarantee Council. Consequently, the States' share of funds comprised only about 25 per cent of the funds available for the implementation of the scheme during 2008-09 and the State budgets did not report nearly three fourths of the available funds.

Even otherwise both the Union Government and the State Governments are simultaneously engaged on the same sectors of economy like health, education, poverty alleviation etc. Since the outlay and the expenditure incurred by the Union Government do not enter the State budgets, the comprehensiveness and transparency of the State budgets gets diminished giving a misleading, even if misinformed, impression of the share of State Government expenditure on social sector schemes. Also, it is no longer possible to readily ascertain the amount allocated (and spent) on a particular sector in a State for correlating it with the outcomes.

The challenge is to evolve a system that makes the State budgets fully comprehensive and transparent.

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<sup>5</sup> Under Article 282 of the Constitution the Union Government is authorized to make grants for any public purpose notwithstanding that the purpose is not one with respect to which the Parliament may make laws.

This may be done through disclosure of the amounts directly released to extra-Government agencies as off-budget items or non-cash credits in favour of the State Governments simultaneously when funds are released to the implementing agencies.

### **Accountability of State Governments**

The next issue relates to accountability of the State Governments. Ordinarily, the Union Government Secretary is accountable for the economical, efficient, effective and transparent use of the resources of the Ministry in achieving the programme objectives while complying with the performance standards<sup>6</sup>. The effectiveness of the Centre's direct 'remote' oversight over the utilization of funds directly transferred to the extra-Government agencies can be highly problematic on account of the widespread dispersal of the such agencies throughout the length and breadth of the country and their sheer numbers. Also, political sensitivities may not permit too searching an examination of the use of Central funds already provided while pressures mount for further releases.

In the case of the National Rural Employment Guarantee Programme, the concerned Union Government Department sought to wash its hands off any responsibility for the lapses in its implementation pointed out in CAG's Audit Report<sup>7</sup> on the plea that the implementation was the responsibility of the State Governments, who are not subordinate to but only coordinates of the Union Government. This was undoubtedly an untenable position since the Department as the nodal agency had the overall responsibility for coordinating and monitoring the administration of the scheme. However, under the scheme, the State Governments were required to nominate an officer not below the rank of Commissioner who would ensure that all activities were carried out as intended. But the State Government functionaries are somewhat psychologically distanced when the money does not come from their budgets for which they are accountable. Their accountability to the Union Government Secretary is also not formally defined. Nor has the Union Secretary any administrative control over them. The challenge is to formally define the precise responsibilities and duties and accountability of the State Government functionary that is supportive of the efficient discharge of the accountability of the Union Government Secretary and establish the accountability obligation of the State Government functionary towards the Union Government Secretary that can be effectively enforced without at the same time doing violence to the [scheme of](#) Centre-State relations as enshrined in the Constitution.

### **Audit by the CAG**

The other challenge relates to the public audit of the expenditure incurred by the extra-Government agencies. The financial system, practices and procedures of some of the implementing agencies are not the ideal ones and the state of financial discipline leaves much to be desired. On the other hand Government of India's internal audit has only a limited outreach and is still in a nascent state besides being handicapped by resource and capacity constraints.. There are inherent limitations in the audit conducted by the Chartered Accountants. In the case of the Urban Local

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<sup>6</sup> Rule 64 of the General Financial Rules 2005

<sup>7</sup> Report No. PA 11 of 2008 Performance audit of implementation of National Rural Employment Guarantee Act

Bodies and the Panchayati Raj Institutions, the authority for audit vests in the Director/Examiner of Local Funds Accounts, which in many States is not an adequate substitute for the audit of the type done by the CAG despite the mandate of providing training, guidance and support available to the latter.

The CAG's mandate for the audit of such extra-Government agencies is defined by law, and unless the prescribed conditionalities are satisfied, the CAG may not be in a position to conduct detailed audit.

It is therefore necessary to revisit the issue of CAG's mandate and both in regard to his jurisdiction and the right of access of records for the fulfillment of the enlarged mandate.

### **Agencification in the Union Government**

In its Thirteenth Report on Organizational Structure of Government of India submitted in April 2009, the (Second) Administrative Reforms Commission has recommended a fundamental redefinition of the role of the Central Ministries confining their remit to policy analysis, planning, policy making and strategic decisions; budgeting and Parliamentary work; monitoring of implementation; appointment of key personnel; coordination; and evaluation. The implementation of Government policies and programmes would be the responsibility of the attached and subordinate offices which would be made autonomous or semi-autonomous and serve as the executing agencies. This has been described as "agencification". Established by or under law these agencies would have independent juristic personalities. This lends heightened importance to some of ~~the issues~~the issues mentioned above.

### **Conclusion**

The advantages of the paradigm shift involving disintermediation of the State Governments in fund transmission and assignment of increasing role to extra-Government agencies or agencification of the Union Government in programme delivery need to be carefully assessed against the potential for accountability deficit created thereby. It is also necessary to put in place a new architecture of financial management, budgeting, accounting and public audit that matches the paradigm shift. The accounting system should be capable of tracking, capturing and reflecting the actual expenditure properly classified that truly reflects its nature; the roles and responsibilities of the various jurisdictions and functionaries and their *inter se* relationship should be clearly defined for pinpointing accountability; the State budgets should reflect the outlays incurred through extra-Government agencies in their jurisdictions and thus become adequately comprehensive as well as transparent; and the CAG's mandate should unambiguously establish his authority to 'follow the rupee' and audit the expenditure irrespective of the agency employed for spending.

# **Audit of Public Enterprises: Three Phased Audit and Other Initiatives**

*K.P. Sasidharan* \*

The pervasive weaknesses in financial industry regulation and global financial system have triggered the subprime crisis, precipitating the ongoing financial predicament, leading to global melt down. The current financial crisis combined with series of corporate governance failures internationally and in the country including recent Satyam fiasco in India has catapulted the issue of corporate governance at the central stage of the governance framework along with the role of independent directors, audit committee, auditors and regulators. In ensuring good corporate governance practices in the public sector enterprises, the regulators like the Ministry of Corporate Affairs, the Institute of Chartered Accountants of India, the Securities and Exchange Board of India, the Reserve Bank of India, and the Comptroller and Auditor General of India (C&AG) have specific individual as well as collective coordinating roles.

This article highlights the process of audit of accounts of PSEs and primarily focuses on how the CAG of India as a regulator has responded to some of the challenges emerging from recent corporate governance failures in addressing issues and concerns relating to audit of public sector enterprises. Before elucidating some of the innovative measures taken by the CAG of India recently to keep abreast with the changing financial scenario as well as maintaining independence of auditors, an attempt has been made to appreciate the efforts of the C&AG in the right perspective countering some of the criticisms against the financial attestation functions of PSEs by the supreme audit institution of India. The article also emphasises the need for collective coordinative action to be taken by the regulators while clamouring for more and more regulatory authorities including regulators of regulators, auditor of auditors and national oversight body to avert governance failure and bring better credibility to the financial reporting and auditing system in the public sector enterprises.

## **Role of the C&AG in Audit of PSEs**

As per the provisions of the Companies Act, 1956 read with Section 19 of the 'Comptroller and Auditor General's (Duties, Powers and Conditions of Service) Act, 1971' and the C&AG's Regulations 2007<sup>8</sup>, the C&AG is vested with audit of the financial statements<sup>9</sup> of all the Government companies. In order to discharge this responsibility, he is empowered to appoint the auditors as well as issue directions to the auditors specifying the manner in which the accounts of government companies are to be audited under Section 619(2) and (3) of the Companies Act, 1956, keeping in view his overall responsibility of ensuring public accountability. As the Supreme Audit Institution of the country, the C&AG plays an oversight role ensuring that the

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<sup>8</sup> Chapter 9 of the C&AG's Regulations on Audit and Accounts 2007

<sup>9</sup> It includes Balance Sheet, Profit & Loss Account/Income & Expenditure Account and, wherever applicable, Cash Flow Statement.

statutory auditors discharge their assigned responsibilities with due diligence on his behalf by exercising the power to supplement or comment upon the statutory auditors' report under Section 619(4) of the Act.

Besides financial audit, the C&AG is also mandated to conduct performance audit and compliance audit of the government companies. Performance audit is an independent assessment or evaluation of an entity's programme or activity with reference to the laid down goals, objectives and targets, taking into account relevant criteria for assessment of efficiency, economy and effectiveness of operations. This is done mainly through the Audit Board mechanism, chaired by the Deputy Comptroller and Auditor General (Commercial), with senior officers of the C&AG and two technical experts inducted as special invitees, if necessary. The main objective of 'performance audit' is to assist the people's representatives in exercising effective legislative control and oversight over the policy objectives and their implementation. The elaborate process of performance audit involves understanding the activities of the organisation, risk assessment, systems and controls, and brings out systemic deficiencies, absence of controls or their ineffective functioning and compliance failures. The Audit probe goes into the root causes of the problems and suggests constructive recommendations to the executives for improvement. In Compliance Audit, the C&AG examines the transactions relating to receipts and expenditure, assets and liabilities of government companies and corporations to ensure compliance with all applicable laws, rules and regulations and procedures.

By conducting audit of PSEs by three frameworks of audit viz. financial audit, performance audit and compliance audit, which are interlinked and complementary to one another, C&AG prepares three distinct audit reports on the functioning of the PSEs, commenting upon their state of financial affairs, operational efficiency, governance and compliance issues. These reports are placed in the Parliament and the selected reports are discussed comprehensively by COPU recommending remedial measures for improvement.

### **The Audit Process in PSEs**

The entire gamut of financial attestation functions of the C&AG encompasses appointment of Auditors by CAG, issuing directions to them, preparation of financial statements by the management, audit thereof by the statutory auditors and supplementary audit by C&AG as detailed below:

(i) Appointment of Auditors: Registration, Empanelment and Allocation of Audit

Ensuring expected quality in financial attestation functions of PSEs has all along been a challenging task. In order to ensure quality of audit, it is imperative that competent, capable and upright audit firms are selected for an assignment taking into account its complexity, magnitude of operations and volume of transactions. The powers to appoint the statutory auditors of the Government companies are, therefore, conferred to the C&AG vide Section 619(2) of the 'Companies Act, 1956' as amended in 2000.

In order to select the competent auditors, the basic eligibility criteria for empanelment for PSE audit are determined in consultation with the Institute of Chartered Accountants (ICAI) that the firm should be registered with ICAI and should have at least one full time FCA member on the date of registration. Applications are invited from eligible CA firms from four regions of the country north, south, east and west every year from 1<sup>st</sup> January to 15<sup>th</sup> February using an on line web based application



format made available in the internet. The input format is developed by the National Informatics Centre and is further updated every year before registration based on the policy changes adopted normally in consultation with the ICAI to keep it abreast with the changing requirements. The data received from the CA firms located across the length and breadth of the country are further cross checked with documents submitted by post by them and more importantly tallied with the data provided by ICAI containing particulars of the firms indicating status, location of head office and branches, partners, employees, their qualifications, experience, association with the firm, income etc. and thus the panel of eligible audit firms is updated in the beginning of every year before allocation of audits is undertaken.

The panel prepared is divided into two categories one for minor audits with a fee not exceeding rupees one lakh and fifty thousand and the other for major audits exceeding audit fee more than that. The criteria for qualifying as a major firm for taking bigger audit assignments is that the firm should have at least six full time CAs of which five should be partners and one can be an employee. The association of partners with the firm is specified as one partner should be with ten years or more, three partners with five years or more and rest of the two partners/CA employee with one year. The process of registration, empanelment, awarding points to firms registered on the basis of accepted criteria on a predetermined point system is computerised and the system is audited by an independent departmental committee of senior officers to ensure data integrity and authenticity. While major firms shortlisted based on the criteria specified are considered for available major audit jobs which range from 150 to 250 or so in a year by a high power departmental committee. The remaining firms in the panel including those firms qualified but could not obtain major audits due to lack of audit assignments are allotted audits by software programme which matches the firms with maximum points in a station with maximum audit fee available in that particular location. The empanelled auditors are much more than the available audits; for example, during the last three years ending March 2009, C&AG empanelled 5381, 6082 and 5084 CA firms, out of which 2786, 2661 and 2657 CA firms were allotted audit.

The credibility and brand equity of C&AG empanelment enhance opportunities of audit firms for being considered for varied audit assignments available with different ministries, departments and institutions of the central and state governments and urban local bodies including corporation, municipality, panchayat and other local organs of state administration. The computerised system of empanelment of auditors for PSE audit assignments has been evolved over the years and criteria and process have been continuously improved as per the emerging requirements. The transparency and objectivity of the system has been acknowledged and appreciated by ICAI, which comes out with suggestions for modifications every year as per professional needs, RBI who uses the panel for appointment of statutory auditors for public sector banks, central government and state governments who call for empanelled auditors for considering for specified accounts and audit assignments including special audits, audit of World Bank aided projects, autonomous bodies and societies available from time to time

(ii) Initiatives taken to ensure independence of Statutory Auditors

The statutory auditors have a fiduciary duty to provide independent, professional opinion on the financial statements of the company audited by them. In order to ensure independence of the statutory auditors and to obviate any chances of conflict

of interest, provisions exist in Section 226 of the 'Companies Act, 1956' disqualifying certain persons for appointment as auditor of a company. Similarly, the Chartered Accountants Act, 1949 also contains provisions to ensure independence of the statutory auditors. The Naresh Chandra Committee, constituted in 2002 by the Government of India for examining the auditor-company relationship made recommendations prohibiting the statutory auditors of the companies from taking certain assignments like internal audit, accounting and book keeping, actuarial services, management functions, valuation services, etc. and recommended rotation of auditors. These well acknowledged safeguards for ensuring independence of auditors have already been factored into allocation of audit assignments of PSEs by C&AG by appointing joint auditors for major PSEs and listed companies, rotating the auditors after a term of four years subject to case to case evaluation, firms' continuous empanelment during the period and their performance and also prohibition of certain non-audit assignments. In order to assess objectively the performance of the audit firms, well structured format with relevant information and parameters has been used and if the performance is found lacking, appropriate penal action is taken against the firm by the departmental disciplinary committee set up for the purpose. The statutory auditors are either cautioned or debarred for allotment of audit up to three years depending upon the nature and magnitude of professional negligence and misconduct.

(iii) Directions, Sub-directions, Additional-directions to the statutory auditors

Before commencement of audit, expectations from the auditors are spelt out explicitly by C&AG by issuing directions under Section 619(3) (a) of the Companies Act, 1956. These directions contain specific questionnaire to assess the quality of corporate governance, preparedness to meet business risks, status of disinvestment if applicable, operational efficiency and productivity, the system of accounts & financial control, possibilities of fraud, the status of assets, inventory, investments, liabilities and loans, award & execution of contracts, quality of the internal audit system, human resource development, status of legal arbitration cases, reliability of information technology and management information system, measured taken towards environment management and issues relating to Memorandum of Understanding and energy audit. Besides general directions under 619(3)(a), the Member Audit Board entrusted with audit of a particular PSE issues industry specific sub-directions to the statutory auditors and discusses the audit plan and related issues in detail in a tri-party meeting where government auditors, statutory auditors and management executives are present. In the current year, three phased audit system has been introduced in 80 odd CPSEs including listed companies, Navaratna, Miniratna, and corporations where C&AG is the sole auditor and during the course of the attestation audit, government audit issues additional directions specific to the CPSE under audit for taking corrective action till the accounts are adopted and signed by the Board of Directors and before the Supplementary Audit under 619(4) is undertaken.

(iv) Preparation of Financial statements by the Management and Audit by Statutory Auditors

The preparation of financial statements in accordance with the financial reporting framework prescribed under the Companies Act, 1956 or other relevant Act (like IRDA, RBI) is the responsibility of the Management of the PSE. The Statutory Auditors appointed by the C&AG under section 619(2) of the Companies Act, 1956 are responsible for expressing an opinion on the financial statements under section 227 of the Companies Act, 1956 based on independent audit in accordance with the

auditing and assurance standards prescribed by ICAI, the professional body and directions given by the C&AG. The statutory auditors are required to submit a copy of the audit report to the CAG under Section 619(4) of the Companies Act, 1956.

(v) **Supplementary audit of financial statements by the CAG Auditors**

The certified accounts along with report of the Statutory Auditors are reviewed by C&AG. On the basis of the review and predetermined parameters, a decision is taken whether to conduct supplementary audit under section 619 (3) (b) of the Companies Act, 1956 of the financial statements of a PSE. This supplementary audit carried out independently is limited primarily to the inquiries of the statutory auditors and Company personnel and a selective examination of some of the accounting records. Based on such a supplementary audit, significant audit observations, if any, are reported under section 619 (4) of the Companies Act, 1956 to be placed before the Annual General Meeting. The supplementary audit by C&AG also oversees any undue observations of auditors, if any, and provides a safeguard to the management of PSEs. The Annual reports of the CPSEs including financial statements are laid before both the houses of the Parliament. A gist of significant audit observations made on the accounts of CPSEs are compiled in C&AG' Audit Report and are laid on both the houses of the Parliament. The Committee of Public Sector Undertakings (COPU) discusses selected audit observations with the administrative ministry and the management of the concerned PSE and recommends appropriate corrective measures for improving the functioning of the PSE in question.

### **Ensuring Public Accountability by Oversight Audit of Financial Statements**

While powers of the C&AG in conducting Compliance Audit and Performance Audit have been appreciated by and large, his powers to conduct Supplementary Audit of PSEs have been a subject matter of debate over the years. The Economic Administrative Reforms Commission (Jha Commission), in its report in 1983, favoured double audit of PSEs; first an audit by a firm of Chartered Accountants who are the statutory auditors of the PSE in question, followed by a Supplementary Audit by the C&AG. The Irani Committee set up by the Ministry of Corporate Affairs in 2005 and the Ad hoc Group of Experts (AGE) under the chairmanship of Dr. Arjun Sengupta constituted by the Department of Public Enterprises, opined that since audit of government companies is conducted by the statutory auditors appointed by the C&AG in the manner directed by him, the Supplementary Audit by the CAG is redundant, duplication of audit and superfluous. More recently, in 2008, the Confederation of Indian Industry and Deloitte in a joint study report, "Autonomy with Accountability: Strengthening Public Sector Enterprises" also criticized the C&AG's supplementary audit functions as an impediment to functional autonomy. The recommendations of the Irani Committee and the Ad hoc Group of Experts on supplementary audit were not eventually accepted by the government like the earlier recommendations of the Jha Commission and Arjun Sengupta Committee.

The C&AG's oversight role is inherently more comprehensive, integrated and in depth than that of the audit responsibility of the statutory auditors appointed by him. As the auditor of PSEs, he conducts audit exercising all the three mandated frameworks of audit viz. compliance audit, financial audit and performance audit to get the totality of the functioning of the enterprises thereby ensuring public accountability and parliamentary control. The fundamental objective of audit of PSEs

is to ensure public accountability by improving the quality of audit. Financial audit is an inevitable component of the audit process. The quality of financial statements and audit certificates of PSEs need to be kept at the expected level. While certifying the accounts and formulating an opinion on the financial health of an organization, the basic objective of improving the quality and readability of financial statements is to be kept in mind while taking an objective and balanced view of the conflicting interests of varied stakeholders.

The statutory auditor is appointed by C&AG and he functions on his behalf. It is his fiduciary responsibility to ensure that the statutory auditor does his job with due diligence complying with applicable statutes, rules and standards. As the overall responsibility is vested upon C&AG, it is important not only to guide, direct, monitor, oversee, review, supplement and complement the financial attestation functions of the statutory auditors but also safeguard the independence of auditors against unethical practices and conflicting demands from the management.

The system has withstood years of criticism, ensuring that fraudulent transactions, recurrent creative accounting and auditing irregularities of the type of Satyam and Global Trust Bank quite rampant in private sector companies are not occurring in the PSEs. Financial accountability is an inevitable element of good corporate governance. It was in this context that in 1956 the parliament and the government of the day prescribed supplementary audit of government companies by the C&AG. The C&AG is responsible for ensuring that public business is conducted in accordance with applicable law, rules and regulations apart from compliance with applicable accounting and auditing standards, and that public money is safeguarded, properly accounted for and utilized economically, efficiently and effectively.

The significance of C&AG's supplementary audit can be gauged from the fact that every year several PSEs revise their accounts after supplementary audit and comments are issued to number of PSEs. In 2006-07, twelve Central PSEs revised their accounts after supplementary audit and comments were issued in respect of 72 Central PSEs besides number of state government PSEs as well. The impact of supplementary audit of accounts of these Central PSEs for the year 2006-07 being the last Report placed in the Parliament was over/under-statement of profit/loss of the companies to the extent of Rs.1095.54 crore and over/understatement of assets and liabilities to the extent of Rs.94.89 crore.

Thus, instead of duplicating the work of the statutory auditor, supplementary audit adds value, credibility, ensures uniformity, consistency and objectivity in treatment of similar type of transactions in identical industrial sector as well as complements the initial audit conducted by the statutory auditor by providing an assurance to the Parliament through an independent authority, that public funds are being utilized in an economical, efficient and effective manner. The supplementary audit by the C&AG has deterrent effects on company's management and statutory auditor as well. As the comments are issued by the C&AG on the accounts, the management takes due care in preparation of accounts and puts its best efforts in presentation thereof in accordance with the applicable statutes, accounting standards and principles and also takes corrective actions. Further, that the arguments advocated against the audit by C&AG does not hold ground is evident from the decision of the government to retain the powers of supplementary audit by C&AG in the Company Amendment bill 2008.

## **Disturbing Research Findings on Fraud and Creative Accounting**

According to World Bank report<sup>10</sup> on observance of standards and codes-accounting and auditing, the Ministry of Corporate Affairs has the mandate to monitor general purpose financial reporting which is exercised primarily through statutory audits. SEBI does not proactively monitor compliance with Clause 49 of the Listing Agreement and financial reporting requirements. Bombay and National Stock Exchanges insist on external auditors to monitor compliance with the accounting and disclosure requirements.

In respect of private sector companies, the external auditors are selected by the management and are generally not rotated. Thus, the independence of the auditors becomes a debatable issue. A large number of listed companies in the private sector have been indulging in financial statement frauds. Cases of Global Trust bank and Satyam are most commonly known. Some of the studies conducted in India revealed that companies have been using techniques of creative accounting.

The joint research conducted by the ICAI and Indiaforensic on “Early Warning Signals of Corporate Frauds” in India revealed that 20-30 percent clients commit the financial statement frauds in India. The major categories of frauds related to cash, inventory, accounts payable, accounts receivable, payroll, and revenue recognition schemes. The major industrial sectors where frauds were identified include manufacturing including pharmaceuticals, real estate and construction, government and public administration, banks and Non Banking Financial Sector, insurance, oil and gas, services, transport and warehousing, media, IT companies etc. An analysis of 500 companies listed on Bombay Stock Exchange conducted by Noble bank revealed that companies resort to creative accounting at times of heightened economic stress characterised by economic slow down in GDP growth combined with profit margin pressure. Prevalent creative accounting practices of the BSE listed companies were identified as recording revenue ahead of time, booking fictitious sales, expense and cash manipulations, invisible restatements of prior periods. The research findings are briefly the following:

- at least 30 companies had been using aggressive revenue recognition techniques;
- around 60 companies seem to had booked sales which might have arisen from investment income or other income;
- at least 10 companies had shifted expenses away from the current period by significantly reducing depreciation rates;
- at least 15 companies which had disbursed the bulk of their loans and advances to companies in which Directors have an interest;
- at least 25 companies had profits shown in the full year results significantly lower than the sum of quarterly results.

These studies establish that the system of certification of accounts of private sector companies is deficient. There is increasing need for regulators like Ministry of Corporate Affairs, Registrar of Companies, Ministry of Finance, SEBI, RBI, ICAI and Stock exchanges to gear up their machinery to curb the unethical creative accounting tendencies, unprofessional conduct of auditors, non adherence to corporate

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<sup>10</sup> Of December 2004

governance tenets and fraudulent transactions of private sector companies including those of listed ones and furthering corporate governance principles in their functioning. It is obvious that the system of audit of financial statements of listed companies advocates that there is a need for oversight functions or supplementary audit not only for audit of PSEs but also for other listed companies in the private sector to protect the interests of large number of minority shareholders.

### **Three Phased Audit System and Other New Initiatives in Audit of Central PSEs**

The root causes of Satyam scam may have yet to be fully investigated and identified; but the fraud has exhibited major accounting irregularities, weaknesses in the control environment, failure on the part of independent directors and the audit committee to ensure corporate governance and negligence on the part of auditors leading to credibility crisis on audit and accounting functions. There is growing expectation gap and demand from the public for re-evaluation of the contemporary Indian accounting and auditing norms, revisiting the audit working processes, principles, procedures and practice to deter possibilities of indulging in deliberate frauds, misreporting and misleading stakeholders.

In order to meet the emerging challenges and to suit the changing environment especially in the backdrop of recent fraudulent transactions in listed companies, the C&AG has issued additional directions to the statutory auditors regarding third party confirmation in respect of bank and cash balances, investment, creditors and debtors while introducing more intensified, innovative, focussed and result oriented approach to financial audit by 'the System of Three Phased Audit'. With a view to bring substantial qualitative transformation in the audit process and methodology, it is imperative to change the mind set of auditors along with innovative strategic transformation in audit approach, targeted to bringing value addition, usefulness, credibility, transparency, visibility and acceptability. Realizing that strengthening the financial reporting system of the PSEs and thereby help implementing internationally benchmarked best corporate governance practices being the ultimate objective of audit, various innovative measures have been initiated for audit of central PSEs recently. Besides, the 'Three Phased Financial Audit System', added emphasis is given to risk based audit approach, corporate governance and intensification of communication process with all the players concerned including statutory auditors, management and other regulators as well. Some of the strategic changes introduced are briefly given below:

#### **(A) Introduction of 'Three Phased Audit System'**

The prime objective of supplementary audit is enhancing the quality of financial statements. Currently financial statements are cluttered with innumerable notes on accounts, qualifications without quantifying the impact, while certifying the financial statements as true and fair. There is a need for better understanding, effective communication, and exchange of views to bring consensus and convergence of ideas in regard to accounting principles, treatment of different accounting entries, application of mandatory accounting standards among the management executives, government auditors, and the statutory auditors, who are actively involved in the financial reporting and audit process with distinct roles and responsibilities. The ultimate test of a qualitatively superior financial reporting is its readability, simplicity and usefulness to different stakeholders including investors in decision making.

Responsibility of an auditor whether he is functioning as statutory auditor or government auditor is essentially strengthening the financial reporting system in the enterprise and thereby facilitating the PSEs to increase its profitability by expanding its core business activities rather than scoring over one another by presenting erudite arguments and counter arguments leading nowhere but help confusing and bewildering the hapless reader of the financial statements. With this objective in mind, a new audit approach viz. 'Three Phased Audit System' has been introduced from the accounting year 2008-09 in 78 selected Central PSEs out of total 419 companies and statutory corporations, falling under the categories of 'listed', 'navratna', 'miniratna' government companies, and 'statutory corporations' where C&AG is the sole auditor.

The new audit approach has three phases aiming at:

- establishing an effective communication and a coordinated approach amongst the statutory auditors, managements and C&AG's audit parties for removal of inconsistencies and doubts relating to the accounts presented by the PSEs;
- identify inconsistencies, if any, before approval of the accounts by the Board of Directors (BODs) of the PSEs, review the accounting of transactions and highlight errors, omissions, non-compliances etc. for timely remedial action to improve the quality of accounts;
- providing adequate time and opportunity to the statutory auditors and the managements of the PSEs to examine the issues identified by the C&AG and make necessary modifications in the accounts instead of presenting the accounts along with observations of statutory auditors and comments emanated from the C&AG's supplementary audit; and
- reducing the time for supplementary audit after the accounts are approved by the BODs of PSEs.

To familiarise the audit entities and the statutory auditors of the objectives and methodology of the of the new audit approach and to elicit cooperation in implementation, 13 high level tri party meetings were organised bringing the management, government auditor, and statutory auditor for detailed deliberations from December 2008 to January 2009 in Bangalore, Delhi, Mumbai, Hyderabad, Kolkata and Kochi. Detailed guidelines were issued which elucidate the process and procedure as under:

**(a) Pre-requisites for Three Phased System of Audit of Annual Accounts**

- (i) The PSEs agree to implement the system and extend active cooperation to audit.
- (ii) A proper and scientific audit risk assessment is undertaken before commencement of first phase of audit for assessing audit risk.
- (iii) Effective Interaction among the government auditor, management and statutory auditor for ensuring successful implementation of the system.
- (iv) As far as possible, the same audit team is assigned all the phases of accounts audit.

- (v) The PSEs are expected to give their draft accounts to the concerned Member Audit Board office concerned along with Schedules to the draft accounts for conducting Phase-II of the audit.

**(b) Audit methodology**

Audit of financial statements may be conducted in three phases as under:

**Phase-I**

Listed companies prepare quarterly financial results (QFR) and submit to the stock exchanges. Other major companies also prepare QFR or half yearly results (HYR). Phase-I audit is conducted on receipt of QFR of second quarter or first HYR. In case of the companies, which do not prepare QFR/HYR, Phase-I audit was conducted in the months of November-December.

Following aspects are covered in the Phase-I Audit:

- (i) Understanding of the accounting system, including IT system, of the PSE;
- (ii) A proper risk assessment, including review of internal control system<sup>11</sup> in the PSE, may be conducted;
- (iii) Analysis of accounting policies, notes to accounts with reference to the applicable laws and disclosures in conformity with the accounting standards as per last years certified accounts; In subsequent years, emphasis should be made only on modifications/proposed modifications adoption of new accounting policies, accounting standards, relevant laws and regulations;
- (iv) An effort is made to bring consistency in the accounting policies of the companies in the same sector;
- (v) Compliance with the previous year's assurances given by the management and issues raised in the 'Management letters'
- (vi) Previous year's audit findings of the statutory auditors and of the C&AG Headquarters office;
- (vii) Modifications in the opening balances, if any, or rectification of errors done by the company may also be reviewed to evaluate the efficacy of the internal control system;
- (viii) Based on the above (items i to vii), quantum of checks to be exercised and department/units to be visited, scope and coverage is decided. Further audit of the draft accounts to be submitted by the Management is conducted in phase-II;
- (ix) Issues of principle, accounting policies, accounting standards, opinions of the Expert Advisory Committee of ICAI are discussed with the

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<sup>11</sup> Before taking a decision whether system based audit or direct substantive testing is to be carried out, existence and effectiveness of internal controls is evaluated. If compliance testing of internal control discloses no exception, reliance is placed upon the internal controls and 'System based audit' (SBA) approach can be adopted. In SBA, substantive testing is reduced and number of units and transaction is checked can be reduced substantially. On the contrary, if compliance testing disclosed exceptions that indicate that the controls being tested are not adequate or are not operating properly in practice, the reasons therefore are ascertained. It is also ascertained whether the exceptions are only an isolated departure or a representative of other departures. In case of weak internal controls, detailed substantive testing is conducted.



management. Proposed changes in the accounting policies and Notes to Accounts are also discussed;

- (x) Preliminary audit findings emanating from Phase-I and points of disagreements are brought to the notice of the statutory auditors. The Management of the PSE are apprised of these audit findings. The issues involved are reconsidered after obtaining reply of the statutory auditors and the management. Final view is taken at MAB level and communicated to the statutory auditors of the PSE in the form of MAB's sub-directions under Section 619(3)(a) of the Companies Act 1956. The Management of the PSE is apprised of the final view to elicit cooperation towards attainment of the objective of compliance with the accepted commercial accounting principles, applicable laws and accounting standards etc.; and
- (xi) Once remedial action is taken by the management, such cases are to be reported for inclusion in CAG's Report as value addition at the instance of C&AG audit. Cases of points of disagreement are processed as comments on accounts.

## **Phase-II**

This is conducted as a test audit at the end of the financial year (i.e. in the month of April) based on the draft accounts received from the PSEs.

The Following aspects are verified during this phase:

- (i) Audit of the units selected in Phase-I based on draft accounts submitted by the PSE are conducted;
- (ii) Review of system of verification of inventories, cash and bank balances including fixed deposits, Investments and other items to be finalised at year end and system of confirmation of balances of debtors, creditors, loans and advances, etc.;
- (iii) Instructions issued by the head office of the PSE to its units for compilation/consolidation of accounts. Any deviation in the instructions from the accounting policies, accounting standards etc. are taken up with the PSE;
- (iv) The PSEs are asked timely to render their draft accounts along with Schedules for the period ending third quarter of the financial year to the MAB office concerned for conducting audit in Phase-II. In case any PSE is not in position to render the draft accounts with Schedules, detailed vouching is carried out on the basis of QFRs. Proper documentation with relevant records of the audit/vouching etc. done during the Phase are maintained for subsequent use and reference.
- (v) Preliminary audit findings noticed as a result of test audit and vouching in Phase-II are issued to statutory auditors of the PSU in the form of sub-directions under Section 619(3)(a) of the Companies Act 1956 with a view to ensuring that the statutory auditors conduct, inter-alia, thorough examination of all such related matters. In the event of non-compliance with the accepted commercial accounting principles, applicable laws and accounting standards, the statutory auditors are required to report appropriately in their report on the financial

statements. The Management of the PSE is also apprised of the final view to elicit cooperation towards compliance with accounting principles, laws and standards etc.

### **Phase-III**

On receipt of financial statements/accounts duly approved by the Board of Directors of the PSE and reported upon by the statutory auditors, the following aspects are verified during this phase:

- (i) Verification of action taken on earlier audit observations;
- (ii) Compliance with the consolidation/grouping instructions;
- (iii) Review of memorandum of changes effected by the PSE in the approved accounts vis-à-vis the draft accounts on which audit in Phase-II was conducted;
- (iv) Accounting and disclosures of the events occurring after the balance sheet date;
- (v) Final disclosures made in the approved accounts;
- (vi) Compliance with the financial reporting requirements of the relevant laws, rules and regulations, accounting standards etc.
- (vii) Examination of the Report of the statutory auditors especially the qualifications, opinions and compliance with relevant Auditing and Assurance Standards; and issue draft audit observations to the statutory auditors as well as the management and to process the same for issuing as comments on accounts.

### **(B) System of issue of Management Letter**

One of the objectives of supplementary audit is to establish communication on audit matters arising from the audit of accounts between the auditor and those who are responsible for implementing good corporate governance in the entity. Material observations on the accounts of government companies are reported as comments by the C&AG under Section 619(4) of the 'Companies Act, 1956. In addition to these comments, irregularities and systemic and control deficiencies observed by C&AG in the financial reports or in the reporting process are also communicated to the management by a 'Management Letter' for taking appropriate remedial measures. These deficiencies generally relate to application and interpretation of accounting policies and practices, adjustments arising out of audit that may have significant effect on the accounts and inadequate or non disclosure of certain information on which management had given assurance that corrective action would be taken in the following year.

### **(C) Risk based audit approach**

In order to utilise the limited resources of Audit and to help PSUs in managing and minimising the probability of inherent risk of financial impropriety in the activities carried out by them rather than being confronted with surprises on the matters related thereto, a risk based audit approach has been adopted. The objective of this approach is to select high risk areas with focused approach, and conduct systematic in depth audit probe taking statistically chosen representative samples of activities or units of an audit entity. This approach relocates audit focus from coverage of 'all

accounting/auditable units' to coverage of 'all major areas of risk' based on objective assessment of risk factors, their significance, materiality and probable impact over a reasonable period of time with definite prompt follow up of audit to see that corrective and preventive actions are in place as a result of audit observations. With a view to give due weightage to financial audit, the audit strategy has been revamped allocating more or less one third audit resources for attestation audit leaving the remaining two third audit resources proportionately for performance audit and compliance audit depending on risk perception.

#### **(D) Interaction with other regulators**

In India, the PSEs are governed by number of Regulatory bodies. The common regulatory Bodies are Ministry of Corporate Affairs, Department of Public Enterprises and the Administrative Ministry. In addition, PSEs are also regulated by other bodies like SEBI for listed PSEs, IRDA for insurance sector PSEs, RBI for banking and non-banking financial PSEs, CERC for power sector PSEs, TRAI for PSEs in telecommunication sector, ICAI for ensuring compliance with applicable accounting and auditing standards etc. These regulatory bodies issues guidelines and directions in its domain of operations. As regulatory institutions are aplenty whose jurisdiction, roles and responsibilities may have overlapping common intersections it is crucial to have purposeful interaction coordination and focused approach among the regulators concerned in a specific sector to help one another executing their assigned job more effectively and efficiently. Besides increasing communication with the Ministry of Corporate Affairs, Department of Public Enterprises, RBI, SEBI and others, various training programmes have been organised in collaboration with some of them on specific emerging issues. ICAI being responsible for ensuring compliance of applicable auditing and accounting standards, 6 Joint workshops are organised with the institute at Delhi, Mumbai, Ernakulam, Kolkata, Lucknow and Jaipur. These workshops were structured to address issues and concerns of CA firms on registration, allocation of work and expectation from them along with dissemination of changes in the Accounting and Auditing and Assurance Standards, International Financial Reporting Standards (IFRS), which are expected to be implemented from April 2010.

#### **Need for Effective Corporate Governance**

In spite of various measures taken by the government and regulatory bodies for good corporate governance, there is still need for establishing effective corporate governance system in PSEs for appropriate public accountability of the management. The following issues relating to corporate governance in PSEs are highlighted in the C&AG's report for facilitating government and regulatory bodies for taking appropriate corrective measures to improve the functioning of PSEs:

- Presently Clause 49 of the Listing Agreement of SEBI requires representation of 'independent directors' on the Board and Audit Committee of listed PSEs. There is no provision in the exiting Companies Act, 1956 for independent directors on the Board and the Audit Committee even for listed companies. Since substantial public funds are involved in PSEs, it is necessary the Board and Audit Committee of PSEs to have sufficient number of independent directors.
- In addition to Government companies registered under the Companies Act, 1956, there are also certain statutory corporations like Food Corporation of

India, Airports Authority of India, National Highways Authority of India and Central Warehousing Corporation established by the Government through special Acts of the Parliament. The Government by making amendments in the Companies Act, 1956 has prescribed good corporate governance practices which are not applicable to the statutory corporations as they are governed by the Special Acts. Consequently these corporations are not required to constitute Audit Committee and prepare Directors'/Members Responsibility Statement despite substantial public money is invested. The Department of Public Enterprises through its guidelines of June 2007 requires all central PSEs to adopt good governance practices but these guidelines are voluntary in nature. With a view to promote more transparent, ethical and fair business practices by statutory corporations, the mandatory provisions for good governance similar to government companies are required to be made for statutory corporations.

- Section 217 (2AA) of the Companies Act, 1956 requires a Directors' Responsibility Statement from the Board of Directors on various matters mentioned above. This Responsibility Statement is part of the Directors' Report under Section 217 of the Companies Act, 1956 which is annexed to the annual financial statements of the company and circulated to the shareholders. This Statement is not the part of the annual financial statements and as such is not subject to review/audit by the auditors. In spite of the assurance given by the Board in their 'Responsibly Statement' that annual accounts are prepared in accordance with applicable accounting standards, number of instances of non-compliances with the provisions of accounting standards are being noticed every year by the statutory auditors and government auditors and reported in their respective audit report. This indicates that the Board of such PSEs does not give the correct statement under Section 217(2AA) of the Companies Act, 1956 to the stakeholders. As this statement is out of the purview of audit, there is no system of its authenticity and may mislead to stakeholders in case of wrong statement.
- Though clause 49 of Listing Agreement requires specified number of independent directors on the Board of PSEs, it was observed in a review by Audit that out of 44 listed government companies, the Board of 30 companies had not been constituted as per clause 49 of the Listing Agreement as it did not contain the required number of independent directors. Similarly, for un-listed PSEs, DPE's guidelines of 1992 require that at least one-third of the Directors on the Board of a CPSE should consist of non official directors. A review found that the Board of 64 unlisted government companies had not been constituted as per the DPE's guidelines as it did not represent the required number of non official directors. Since the power to appoint the directors on the Board of PSEs vests with the Government, there is need to take appropriate action for the induction of independent or non-official directors on the Board of deficient government companies.

## **Conclusion**

The inevitable solution to persisting and pervasive financial irregularities, creative accounting jugglery, non compliance of applicable laws, standards and principles, systemic and control deficiencies in the corporate sector in particular private sector companies leads to ensuring effective implementation of internationally benchmarked best practices of corporate governance. No doubt, the statutory frameworks are in place, mandatory acts, regulations, rules, standards, principles, procedures, directions, guidelines and best practices are well known and aplenty; regulatory bodies overseeing the corporate business activities for effective enforcement are constituted, alive, kicking and functioning; and board of directors, audit committee, independent directors, statutory auditors and government auditors are all in the corporate arena seized of the problems and issues with defined roles, tasks and responsibilities. Nevertheless effective implementation of corporate governance has a long way to go. Time has come for cooperation coordination intense focused result oriented interaction, exchange of views among all the players in the corporate arena for better approach, methodology, and action plan to help one another in discharging their assigned role by coordinated and collective action.

Financial statements, reporting and audit process are some of the significant instruments which can help effective implementation of corporate governance by value addition, building credibility, usefulness and investor confidence. Strengthening the monitoring and enforcement mechanism necessarily requires appointment of independent and competent auditors. Some of the important issues to be considered are facilitating coordination among multiple regulatory bodies, bridging the gap between IFRS and Indian Accounting Standards, International Standard on Auditing (ISA) and Indian Auditing and Assurance Standard and most importantly, introducing effective mechanism to enforce adherence to professional code of ethics by the auditors.

Failures in corporate governance may lead to clamor for giving birth to more regulatory bodies in the form of regulator of regulators, independent auditor of auditors, independent national audit oversight bodies etc. replicating the pattern of USA, UK, Australia, Canada, Japan and European Union rather than evaluating and revisiting the role and responsibility structures of the existing regulators and taking appropriate measures for monitoring and enforcement of good corporate governance. The office of the C&AG has reviewed its role and responsibility in the context of recent corporate governance failures and geared up its machinery to ensure accountability, transparency, probity, equity and fairness in the audit of PSEs. As the Supreme Audit Institution of the country the C&AG of India has an important role in facilitating implementation of good governance of PSEs by reporting significant and material audit findings along with recommendations for remedial action in his audit reports wherever deemed necessary.

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# Public Financial Management: Issues concerning Public Private Partnerships

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1. The concept of “Public Private Partnership” (PPP) has been widely used for creation of community assets in many countries, particularly in the developed world. The Carter Administration in the USA is rather well-known amongst public finance professionals for revitalizing the concept of Zero Based Budgeting. Another landmark development associated with that Administration was sowing the seeds of what we today know as PPP. It was then widely recognized<sup>1</sup>, perhaps for the first time, that government resources and powers could not alone resolve many complex issues of public service delivery. Public-private partnerships were seen as a means to make creative use of a time of governmental austerity by bringing to bear the complementary powers of both sectors. To pursue this objective, a special partnership promotion unit was established in the Department of Housing and Urban Development. Subsequently, in the Reagan Administration, the concept gathered strength.

2. The decade of 1980s saw the emergence of a dominant thinking about diminishing the role of government and increasing the role of free market mechanism under the strong leadership of President Ronald Reagan and Prime Minister Margaret Thatcher. They gave an impetus to privatization of public services in USA and UK. The new thinking was based on the basic premise that the government is unable to provide quality public services either due to lack of either financial resources or of required efficiency and flexibility. Efforts at whittling down the grizzly grip of government even in the countries generally perceived to be capitalistic started in many directions including outright disinvestment / privatization of public assets / services. A wave of PPP followed that of privatization. In UK, earliest PPP projects were for creation of new privately operated jails. In December 1995 and January 1996, the Prison Service awarded contracts to private sector contractors to design and construct and finance new prisons at Fazakerley and Bridgend and operate them for a period of 25 years, with the buildings being transferred to the public sector at the end of the period.

3. PPP is a new institutional mechanism forming part of an emerging paradigm shift in governance. It signifies a formal, contractual arrangement between a government and a private entity in furtherance of shared common interests. Although the term PPP has gained visibility in recent years, it has existed for long albeit in less formal forms. Public donation of beds or hospital wards in government hospitals, Government acceptance of voluntary donations for Bharat Shiksha Kosh, provision of land at nominal lease rent or concessional sale price for construction of schools and hospitals is one such common arrangement. Similarly, area development (provision of rail/ road/ port/ communication and power infrastructure in an area) or tax holidays to attract setting up of greenfield projects by private industries in remote, backward areas or use of statutory power to acquire land to facilitate provision of land for such projects are also forms of PPP though not termed as such. Pre-sale cleaning up of balance sheets of public sector enterprises can also be viewed as PPP.

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4. A rather comprehensive study<sup>2</sup> of PPP was carried out by the International Monetary Fund in 2004. It noted that there is no clear agreement on what does and what does not constitute a PPP. In a 2003 paper, the European Commission defined PPP as “the transfer to the private sector of investment projects that traditionally have been executed or financed by the public sector”. But in addition to private execution and financing of public investment, PPPs have two other important characteristics: there is an emphasis on service provision, as well as investment, by the private sector; and significant risk is transferred from the government to the private sector. Other ways in which the role of government in the economy has been reduced since mid-1980s—including privatization, joint ventures, franchising, and contracting out—share some or all of these characteristics. PPPs are distinct from these in that they represent cooperation between the government and the private sector to build new infrastructure assets and to provide the related services. Concessions and operating leases—which have also been used to reduce the role of government in the economy—are forms of PPP.

5. The term "Public-Private Partnership" has been used<sup>1</sup> to describe quite different sets of relationships, such as consultation by public agencies with private businesses or community groups or arrangements such as the "load-shedding" of public functions to the private sector, as, for example, when businesses are made responsible for their own waste disposal. The PPP includes government 's tie up with private commercial undertakings as well as with not-for-profit organizations/ NGOs/ Voluntary Agencies. A growing trend is the big (private) corporations setting up their arms to take up socially relevant projects in collaboration with governments to substantially upscale such projects by injecting organizational and entrepreneurial skills and resources under the umbrella of Corporate Social Responsibility. Such ventures have not been free from controversies where subtle mixing of commerce and charity has evoked strong reactions. Essentially the criticism is that such ventures may either be actually (efficiently run) pure commercial ventures or vehicles of individual publicity. That such 'foreign aid' distorts domestic priorities, driven by the perceptions and priorities of donors' stake holders. A typically dilemma faced by the governments is whether and to what extent the donors be allowed to choose the beneficiaries for improved visibility of their efforts. For example, if the Central government has a policy of routing all external aid through a fixed mixture of loans and grants, how far can it go in accepting external donors' desire to bye-pass this 'averaging and pooling' role of the Central government and insist on their grants being passed on a s grants to identified beneficiaries.

6. The private sector partner brings with it not only financial capital but also intangible investment in terms of a 'different' work culture, a fine differentiation of sundry consumer needs, and concomitantly different revenue models for different market segments and innovative, unconventional methods of handling delinquent consumers or for expanding the market. The Telecom sector has seen a lot of these developments. The varying shades of PPP being experimented in the electricity supply / distribution hold great potential of reforms in this still ailing sector. Their game-changing tactics is a source of comfort or consternation for different stakeholders.

7. The 2008 global financial crisis, with its looming shadow continuing to haunt us, has brought back the debate on the desirability of unbridled free market capitalism, and helped revive anti-liberalization, anti-reform ideologies. There is a clear and present danger of a swing from excesses of capitalism to the other extreme.



Market failure, bad regulation or fraudulent acts of a greedy few should not be an excuse to discard the gains of liberalization and reforms. Wrongs have to be corrected with surgical precision but it would not be prudent to throw the baby with the bathwater and revert to pervasive State control. Just as greed, poor governance and judgment lapses may ground companies, hasty governmental decisions based on incomplete data can also cause, perhaps even more irreparable and long-lasting, damage to the economy. Whether in the affairs of corporate entities or governments, the real enduring concern is ‘good governance’ marked by foresight and oversight; guarded by enlightened/ empowered shareholders/ citizens and strong oversight/regulatory mechanisms.

### **What is Public and what is Private?**

8. The experience of different countries in this area is rather divergent because role of State is based on the country’s political ideology. Generally, education and health services are provided by government agencies as well as by private charities and commercial entities, but these are largely financed by public exchequer. Mass transportation, originally private, became largely a public function as costs rose higher than fares could finance. Community services such as water supply and waste disposal are generally public sector operations. Electricity, POL and gas supplies, roads, ports telecom are usually handled by private companies in capitalist countries and by government owned enterprises in others but the trend is towards privatization.

9. Public-private partnerships (PPPs) involve private sector supply of infrastructure assets and services that have traditionally been provided by the government.<sup>2</sup> A typical PPP takes the form of a design-build-finance-operate (DBFO) scheme. The government is in many cases the main purchaser of services provided under a PPP. These services can be purchased either for the government’s own use, as an input to provide another service, or on behalf of final consumers; a prison, a school, and a free-access road would fall into these respective categories. Private operators also sell services directly to the public, as with a toll road or railway. Such an arrangement is often referred to as a concession, and the private operator of a concession (the concessionaire) pays the government a concession fee and/or a share of profits. Typically, the private operator owns the PPP asset while operating it under a DBFO scheme, and the asset is transferred to the government at the end of the operating contract, usually for less than its true residual value (and often at zero or a small nominal cost).

10. The term PPP is sometimes used to describe a wider range of arrangements. In particular, some PPPs exclude functions that characterize DBFO schemes. Most common in this respect are schemes which combine traditional public investment and private sector operation of a government-owned asset. This arrangement sometimes takes the form of an operating lease, although in cases where the private operator has some responsibility for asset maintenance and improvement, this is also described as a concession. Operating leases and similar arrangements are typically regarded as PPPs. However, private sector involvement in asset building alone—which can take the form of a design-build-finance-transfer (DBFT) scheme or a financial lease—is not strictly speaking a PPP, since it does not involve service provision by the private sector. In some cases, the public sector partner is a public enterprise rather than the government. In Indian context, the term PPPs is used for projects involving both investment and service delivery by the private sector, and private financing and

ownership and is presently concentrated in provision of physical infrastructure like roads and ports. Social sector PPP is now gaining momentum. For example, development of industrial/technical skills has been identified as a priority area in Human Resource Development and upgradation of it with private sector participation is on the anvil. For elementary and Secondary Education, there is tremendous scope of PPP. Partnerships here can range from adopt-a-school programs, mentoring programs, joint efforts to modify curriculum, introduction of new technology, distance learning, educational content generation etc. Alternative schools, often with a job training emphasis, now complement conventional schools are gaining significance. Private corporations are expanding their activities under Corporate Social Responsibility with increased focus on rural areas which also makes good long-term business sense.

### **The institutional mechanism for approval of PPP Projects by the Government of India**

11. The Central Government has in place an elaborate system for investment approval relating to Public sector projects revolving around the Public Investment Board (PIB) chaired by Secretary, Department of Expenditure with the Planning Commission providing independent appraisal through the Project Appraisal Division, followed by approval of the Cabinet/CCEA.

12. PPP projects in sectors such as roads, ports, airports and urban infrastructure are not ordinary private sector projects, which are governed by competitive markets, where prices are determined competitively and government resources are not involved. In the PPP projects, there would be need for due diligence by the government because the projects typically involve:

- (i) Transfer of public assets, including land (e.g. an existing road or airport facility);
- (ii) Delegation of governmental authority to collect and appropriate user charges that are levied by force of law and must therefore be 'reasonable';
- (iii) Provision of services to users in a monopoly or semi-monopoly situation, which imposes a special obligation on the government to ensure adequate service quality; and
- (iv) Sharing of risks and contingent liabilities by the government, e.g. when claims are made under the respective agreements or when the Central Government has to provide a backup guarantee for non-performance by the entity granting the concession. Even where an explicit guarantee is not included there is a danger that non-performance on part of the State Governments could attract claims under bilateral investment promotion agreements.

13. As reliance on PPPs increase, the terms of the projects will invite close scrutiny. Disputes arising out of project terms could also lead to significant payouts by the government, underscoring the importance of careful design of concession terms. These concerns are not addressed even if project sponsors are selected through competitive bidding. In fact competitive bidding only creates a level playing field for selection of bidders; it may not necessarily secure good value in terms of performance

standards, user concerns, public revenues and contingent liabilities. Project terms are, therefore, crucial.

14. Recognising these problems, a 3 tier mechanism has been set up<sup>3</sup> for pre-sanction appraisal of public private partnership (PPP) projects as follows:-

15. At the apex level is the Public Private Partnership Approval Committee (PPPAC) chaired by Secretary, Department of Economic Affairs includes Secretary, Planning Commission, Secretary, Department of Expenditure, Secretary, Department of Legal Affairs and Secretary of the Department sponsoring the PPP project. It takes up all PPP Projects where the underlying asset value is more than Rs.250 crore (Rs.500 crore in the case of National Highway projects]. For appraisal of PPP projects costing greater than Rs.100 crore (Rs.250 crore in the case of National Highway projects) but less than Rs.250 crore (Rs.500 crore in the case of National Highway projects), a smaller Committee has been set up comprising of the Secretary, Department of Economic Affairs and the Secretary of the Ministry /Department sponsoring the project. All smaller projects are appraised by Standing Finance Committee (SFC) / Expenditure Finance Committee (EFC) which appraise government-funded projects.

16. The Planning Commission will set up a PPP Appraisal Unit (PPPAU), similar to the existing PAMD which appraises public sector projects. This unit will prepare an appraisal note for the PPPAC providing specific suggestions for improving the concession terms, where this is possible.

17. The sponsoring Ministry/entity will identify the projects to be taken up through PPPs and undertake preparation of feasibility studies, project agreements etc. with the assistance of legal, financial and technical experts as necessary. The Ministry concerned may develop individual proposals using legal, financial and technical consultants and also avail the benefit of an inter-ministerial consultative group. A panel of consulting firms has been drawn up by the government. The proposal as formulated by the Ministry would be considered by the PPP Appraisal Committee for 'in principle' clearance before inviting expressions of interest from prospective investors. Following the 'in principle' clearance of PPPAC, the Administrative Ministry may invite expressions of interest in the form of Request for Qualification (RFQ) to be followed by shortlisting of pre-qualified bidders.

18. Initially the projects will be appraised by the Standing Finance Committee (SFC) chaired by the Secretary of the concerned Administrative Ministry. This would include the Department's Financial Adviser (Member), Joint Secretary of the concerned Division (Member), and representative of the Department of Legal Affairs (Member). The Committee would inter alia see that the bidding is according to the procedure endorsed by PPPAC. This includes the process of two-stage bidding, pre-bid qualification norms etc. This implies that in the first stage, NHAI could short list and pre-qualify bidders on the basis of pre-bid qualification norms for inviting financial bids in the second stage. SFC will also ensure that the Model Concession Agreement (MCA) approved by the Competent Authority is being followed; that the project has been designed in accordance with the manual of standards and specifications as approved by the competent authority in the Administrative Ministry and stipulated in the approved Model Concession Agreement (MCA).

19. The documents that would need to be prepared would, inter alia, include the various agreements to be entered into with the concessionaire detailing the terms of

the concession and the rights and obligations of the various parties. These project documents would vary depending on the sector and type of project. Typically, a PPP will involve the concession agreement that will specify the terms of the concession granted to the private party and will include the rights and obligations of all parties. There could be associated agreements based on specific requirements.

20. RFP (Request for Proposals), i.e. invitation to submit financial bids should include a copy of all the agreements that are proposed to be entered into with the successful bidder. After formulating the draft RFP, the Administrative Ministry would seek clearance of the SFC.

21. Ministry of Defence, Department of Atomic Energy and Department of Space are exempt from the purview of these guidelines.

22. In keeping with the commitment to promote e-governance, Ministry of Finance (MoF) has created a dedicated website<sup>5</sup> on all PPP projects for the guidance of prospective partners and general public alike, giving online access to various guidelines, formats and checklists. We learn that so far( 6th June 2009), 99 PPP Projects have been sanctioned, earliest approved on 29.08.2006 being “Setting up of Iron ore handling facilities on BOT basis at New Mangalore Port”. The aggregate ‘project cost’ of these 99 projects is Rs.97949.443 crore. As on 6th June 2009, there were 23 PPP projects with aggregate ‘project cost’ of Rs.23221.07 crore were under consideration and 9 other projects (Rs. 8845.36 crore) returned by PPPAC with comments or withdrawn by sponsoring Departments.

### **Major issues concerning PPPs: Fiscal Transparency**

23. Since PPP means creation of infrastructure and services without governments and public sector entities having to increase the borrowings or to raise taxation, this type of governance reforms also entails dilution of traditional legislative financial control on taxation and public borrowing. An earmarked tax / cess on air travellers is under direct legislative regulation but UDF collected from air passengers is not. PPP is a quasi-fiscal activity that is typically not fully captured in budget documents presented to legislatures. Hence, one important issue arising out of PPP is that of fiscal transparency: Disclosure of contractual and quasi-contractual liabilities/commitments assumed by a government under PPP in estimated financial terms. “There is not yet a comprehensive fiscal accounting and reporting standard for PPPs<sup>2</sup>. However, existing standards cover a number of PPP operations that can be reported in a straightforward manner. Accounting for PPPs that involve limited risk transfer to the private sector is more complex. In the absence of the internationally agreed guidance on how to do this, the known and potential future cost of PPPs—which derive from the government’s contractual obligation to purchase services from the private sector and from government guarantees, respectively—should be disclosed, and taken into account when undertaking debt sustainability analysis. Once an internationally accepted accounting and reporting standard for PPPs is developed, it should be used if it adequately meets the need for transparency and provides an appropriate basis for assessing the fiscal consequences of PPPs. The IMF Paper further notes as follows: “*However, it cannot be taken for granted that PPPs are more efficient than public investment and government supply of services. One particular concern is that PPPs can be used mainly to bypass spending controls, and to move public investment off budget and debt off the government balance sheet, while*

*the government still bears most of the risk involved and faces potentially large fiscal costs. ....Adequate risk transfer from the government to the private sector is a key requirement if PPPs are to deliver high-quality and cost-effective services to consumers and the government. But this is only one of a number of preconditions for success. The quality of services has to be contractible, so that payments to service providers can be linked to their performance and the need for costly contract renegotiation is minimized, and there has to be either competition or incentive-based regulation, which is essential for efficiency. An appropriate institutional framework characterized by political commitment, good governance, and clear supporting legislation is also needed. In addition, the government will have to develop the skills needed to manage a PPP program, and in particular to refine its project appraisal and prioritization”.*

### **Major issues concerning PPPs: Should the PPP operators be treated as extended arm of government?**

#### ***PPP operators and Articles 12 & 14 of the Constitution***

24. This question is relevant in two contexts. Firstly, the applicability of Art 12 of the Constitution and secondly the applicability of the Right To Information Act to the PPP operators. Article 12 of the Constitution defines "the State" as including including the Government and Parliament of India and the Government and the Legislature of each of the States and all local or other authorities within the territory of India or under the control of the Government of India. Major significance of this definition of the 'the State' lies in Article 14 of the Constitution that grants the Fundamental Right of equality before law. It mandates that the State shall not deny to any person equality before the law or the equal protection of the laws within the territory of India. A rich body of jurisprudence has evolved around Article 12 and 14 in which the Supreme Court and the High Courts have held that the Government owned / controlled companies/corporations/societies etc are 'agencies and instrumentality' of the State and are therefore bound by the obligations cast on the 'State' under Article 14. Even though many of these entities may not be making 'laws' or 'statutory rules/regulations', even in implementing their administrative instructions, they have to ensure that equals are treated equally. They cannot arbitrarily discriminate in their dealings with general public. There has to be a reasonable classification and discernible nexus between the basis and object of classification and these matters are open to judicial scrutiny. The underlying idea is that the extended arms of government cannot adopt arbitrary pick and choose policy either for giving favorable treatment or for harassment. A moot point here is if the PPP operators can be include in the definition of 'the State' under Article 12 of the Constitution. Thus, a private agency engaged for survey of land for acquisition would be expected to follow transparent non-discriminatory norms for selection of particular pieces of land. Similar obligations would apply to private agencies operating towing services for traffic police for selection of illegally parked vehicles for towing or to toll road operators for arbitrary granting or denial of privileges to particular vehicles.

#### ***Is a PPP operator covered by the RTI Act?***

25. A related question whether a PPP operator is covered by the RTI Act is perhaps less vexed. A "public authority" includes non-Government organization

substantially financed, directly or indirectly by funds provided by the appropriate Government. Thus, power distribution companies are being called upon to entertain applications under the RTI Act.

**Major issues concerning PPPs: PPPs result in shift from ‘taxation by law’ to ‘quasi-taxation through contract’.**

26. The essence of a tax is absence of direct quid pro quo and enforcement of liability to pay by law. Cesses and other statutory levies like Road Cess on petrol or Education Cess or Mandi fees or special rates of land revenue for irrigated lands do have some declared nexus with particular objects on which the proceeds are spent for target group of beneficiaries, the fungibility of resources in a Consolidated Fund system makes the nexus rather tenuous. Even rates and tariffs for services provided by government backed monopolies are as good as tax in substance if not in form. What is needed, more than a mere legalistic approach, is to ensure that there is enough transparency about the basis of fixation of tariff and its non-discriminatory enforcement.

**Major issues concerning PPPs: role and methodology of Audit**

27. World over, PPP has been promoted to upgrade the nation's infrastructure and improve the quality of its public services on two considerations: public sector being severely constrained in its use of public funds and the public sector not being able to provide the most efficient and cost-effective infrastructure. A PPP is essentially an exercise to match the complementarity that exists between government and private enterprises. How real or supposed is this complementarity potentially stirs strong political and ideological debate. Lack of financial resources on the part of the government is the most cited and contested argument to support PPP. However, the other important driving force, perceived lack of flexibility, efficiency and managerial skills within the government machinery, finds greater acceptance. That is why PPP is not just part of fiscal reforms but also of governance reforms. Therefore, PPP cast very special responsibility on Audit.

28. It is axiomatic to say that the government system is too rigid and is based on mistrust. Hence, it entails intrusive regulation, curtailment of discretion, innovation and leads often to decision atrophy or sub-optimal business decisions. The same considerations of business facilitation that require government inspectors and auditors to keep away from the business premises call for a similar hands-off for PPP also. Rather than peeping into private records, the government policy encourages reposing trust in voluntary declarations by private entities. Search and seizures have given way to technology, psychology and systemic checks and controls to enforce tax compliance. The same approach is likely to continue for PPP too. For, Audit is also perceived as part of the ‘stifling’ government mechanism amongst others. As mentioned above, PPP entails dilution of traditional legislative control with concomitant impact on Audit as well. It calls for new instruments of oversight by civil society through media, judiciary, alert and empowered citizenry through frameworks like the Right to Information Act. Obviously, Audit stance, focus and strategy needs re-orientation and a re-look at its mandate and its tools.

29. In examining the PPP Projects, auditors are chartering into an area where policy and ideology come into play and where they risk ending up into private domain

in hot chase of 'public interest' for which they are not sufficiently prepared or mandated. Audit is already grappling with the Production Sharing Contracts concluded by the government with private companies in the area of crude oil production and conceptually similar Revenue Sharing arrangements with the Telecom service providers. What mandate, expertise or preparedness does Audit have to verify actual production or actual shareable revenues of a private company? Similar dilemma exists in the case of verification of traffic/revenue on tolled roads operating under BOT contracts or the adequacy of UDF vis-à-vis the net financial burden on the private operator of an airport under a long term concession agreement.

30. In view of the above limitations, Audit has to tread very cautiously in examining PPP Projects and reporting to the Legislature its findings and recommendations. Conventional Audit approach is to hold the government accountable in terms of the rules and norms set by itself or by the Legislature or the framework of a legally binding agreement. Rarely does Audit use its own yardstick or comparable benchmarks to judge the actions and decisions of government. PPP is one area where general legislative and executive norms are not in place and perhaps the sole source of 'standard to judge' the outcome of PPP project would be the underlying contract with the private sector partner. Government has recognized that in view of the size and complexity of PPP projects, it may be necessary to secure the assistance of qualified legal, financial or technical experts to undertake the requisite due diligence. This may be necessary in order to protect government interest, particularly in the face of highly qualified expertise that the private sector participants may employ while negotiating these projects. Accordingly Planning Commission and the Finance Ministry have been authorized to engage the experts as necessary. The reports of the external consultants would thus be another important input for Audit besides the contract agreement.

31. One of the areas of Audit would be the valuation of underlying assets to decide the appraisal forum. At the early stage of project formulation, it may be practically infeasible to very accurately estimate it. There can be both over and under estimation based on imperfect data. Since the sanctioning powers are the same as those applicable to public sector investment, the wrong assessment may lead to appraisal of the project by the wrong forum. Splitting a financial proposal to avoid going to higher Competent Financial Authority is a common Audit point. The under or over-assessment comes to light later when the true cost drivers come into play. The usual defence offered is that the Audit has the benefit of hindsight.

32. Another important element of Audit scrutiny would be the valuation of existing government / public sector owned assets transferred to the private operator [such as land as equity for greenfield projects or modernization/expansion of airports or redevelopment of ONGC discovered oilfields]. Obviously, Greenfield BOT projects would pose lesser difficulty in scrutiny than the ROT [Rebuild Own Transfer] projects. Valuation issues would be similar to that of valuation of financial or physical assets slated for outright sale but the valuation methodology and considerations may differ.

33. An important aspect of Audit scrutiny is the examination of bidding parameters to select the private operator. The concession period, rates and tariffs, estimated traffic, escalation, capital expenditure, and savings are inter-dependent parameters. The overall public good delivered by PPP in quantitative term is a complex function of various such parameters. Unless the RFP asks quotes for

different options separately, least cost to the government or the most optimum revenue model would be difficult to arrive at. It is desirable to have as many different bidding options for the government to take an informed decision after looking at all different permutations and combinations. For example, in a quote for BOT project it may be useful to have quotes for different concession periods including permanent concession i.e., what would you quote if T is dropped from BOT? How does it impact on the user charges? ]

34. The standard norms of government contracts as laid down in Rule 204 of General Financial Rules require substantial augmentation when it comes to PPP contracts. The PPP contracts are most likely to be found deficient in the very first fundamental norm expected of government contracts, viz., “The terms of contract must be precise, definite and without any ambiguities. The terms should not involve an uncertain or indefinite liability, except in the case of a cost plus contract or where there is a price variation clause in the contract.” By its very nature, ambiguities are bound to be there because everything cannot be foreseen over the long life of a concession agreement.

35. There are two different aspects of government contracts where the classical model of benchmark setting and evaluation may be difficult to apply. Firstly, there is a generally tacit assumption that the government is in a dominant position in concluding the contract, is able to dictate terms to the other side and the contracting officers are expected to maximize the leverage for the government in the bargain. However, government may not always be in a position to dictate terms in a contract. It is a give and take on both sides and has to be appreciated as such. Secondly, even if individual clauses of a contract may appear to be less favorable to the government, a contract has to be judged by its overall achievement because there is a give and take across the various clauses. This increases the difficulty for Audit in drawing adverse inferences from looking at particular clauses only. The overall PPP contract is usually too big, complex and inter-connected to lend itself to selective adverse comment on particular clauses.

36. Usually the institutional mechanism to support the PPP is embedded in a long term legally enforceable contract with its attendant benefits and problems. Neither government nor the private operators have the crystal balls to gaze the long term future scenario of projection of revenues, inflation, capital expenditure, maintenance needs, provision for unforeseen contingencies, actual demand for the services etc. From Audit viewpoint there may be over-assessment of perceived risks and uncertainties in the concession agreement and an element of subjectivity cannot be ruled out. Behind even the most complex mathematical models of investment appraisal, analysis IRR ERR lie subjective assessments/assumptions. As shown by the ongoing global financial and economic crisis, behind complex mathematical models lie sheer personal judgment that can be quite insulated from ground realities. An Expressway or airport designed to reach its full capacity utilization in 10 years can get saturated in just 2 years or the rosy estimates of demand for mobile telecom services can go awry in the very first year of license. It may be recalled that the migration from fixed telecom license fee to revenue sharing regime was prompted by unrealistic projections of telecom traffic demand. What Audit can do is to highlight the assumptions underlying the concession agreement.



## **Major issues concerning PPPs: Appropriate institutional mechanism to support the PPP and handling resistance**

37. One alternative to overcome this problem of over-estimation of risks over the long concession period is to implement the PPP through a Joint Venture company route. Here the risks would be jointly managed as and when they occur with more precise, up-to-date information in hand rather than being speculated at the commencement of the concession period. The corporate boundary would also provide better transparency about costs, revenues and profits. However, the problematic side is to determine deciding the extent of government's participation in the equity capital and management of the JV company. How much operational autonomy can such a company enjoy is an important issue. After all, as mentioned above, one of the driving consideration behind PPP is to offload the budget and bring in private sector dynamism to public institutions. Naturally this implies some whittling down of control by the State and its arms: The Legislature, Judiciary, C&AG, CVC, CBI, and government agencies (such as DPE regulation of government companies).

38. Total privatization coupled with statute-based prudential regulation can be yet another model to substitute but there the problematic area is the pricing of the government privileges handed over to private parties for a consideration such as licensing of electro-magnetic spectrum, airtime, air flight rights acquired under government-to-government agreements. It would perhaps be in the widest interest of the economy if public services could be entrusted to professional, board-run, widely held companies which are governed by strong regulatory mechanism backed by law. Here one contentious aspect would be the scope of regulation. At the minimalist end of the spectrum, the regulation can confine itself to maintaining fair competition and standards of quality of services whereas at the other extreme it can cover not just price/ tariff control but also profit control or executive pay control.

39. Business-friendly policies discourage inspector raj because it breeds corruption but the build-up of credible alternative institutions has been a glacial process. For example, the alternative to government inspectors checking food adulteration, weights & measures of goods sold, sale of unsafe electrical appliances will have to be a very strong consumer awareness movement, community action, strong network of NGOs, unclogged judicial system and a change of mindset where individual citizen learns not to depend on government for everything in his daily life. The difference between simple outsourcing to get additional (less expensive and more responsive) manpower to a formal PPP mechanism is only in scope, not in underlying guiding philosophy. It is little surprise therefore that resistance to PPP is coming from those suffering from injured pride or adversely affected vested interests. For example, some municipal bodies are resisting implementation of Solid Waste Management Projects through State PSUs under PPP model stating that it is against 74<sup>th</sup> Constitutional Amendment. Instead of empowering local bodies, government is taking away even their traditional functions, e.g. under JNNURM programme.

40. The world is realizing the virtues of Middle Path as champions of free market capitalism are returning to State control and those of absolute, monolithic State power are embracing shades of capitalism. The whole game is about plumbing the right balance between the two extremes. PPP projects epitomize this dilemma. We need a fair, reasonable and balanced PPP contract. Any perceived tilt towards either contracting side invites adverse attention from the other side. PPP is here to stay. We have to see how best to implement it to inspire public confidence. Clearly, Audit has its role cut out.

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## **BOOK SECTION:**

### **Indian Audit – A Historical Perspective**

*B.M. Oza\**

It is indeed a matter of satisfaction that within a few months we are getting the opportunity to talk about a second book on Indian Audit. This time the book is : “The Comptroller & Auditor General of India – A Thematic History 1990-2007”. The author is Shri Vijay Kumar, former Deputy Comptroller and Auditor General and Chairman, Audit Board. The history is presented in two volumes, running over 900 pages and is replete with extracts from Audit Reports, various documents, photographs and sketches to capture the years that have gone by.

This work on the history of CAG’s organisation has in fact been commissioned by the CAG himself. The purpose evidently is to bring on record the important developments during the period from 1990 to 2007 which is co-terminus with the tenure of the last three CAGs, namely, Shri C.G.Somiah, Shri V.K.Shunglu and Shri V.N.Kaul. Shri Kaul records in his Foreword that ‘though this history was commissioned by the department, I have tried to ensure that the author has full autonomy and independence to highlight matters that he considers important.’ Shri Vijay Kumar confirms this in his Preface and also adds that ‘he (CAG) had only one word of caution that the history recorded by me should reflect an entirely objective narration of the developments during the period in question’. The reader can therefore safely take this history as a faithful, objective and reliable record of developments in the department during this period.

Any discussion on any work relating to the history of Indian Audit has to start by referring to the monumental work by Shri R.K.Chandrasekharan, whose masterful and patient record of events spanning four decades has made the most valuable contribution to the literature on this subject. Shri Vijay Kumar has done the same thing by including in his overview chapter a brief summary of the history till the year 1989, apart from summing up all the developments after 1990. This in a way, makes this book a complete history, since many of the present developments have to be appreciated in the light of what happened in the past. However, we must note here a significant difference between the work of Shri Chandrasekharan and the present book. While Shri Chandrasekharan went chronologically describing all developments, Shri Vijay Kumar has chosen to present the history of this period in a thematic manner. In my view this is appropriately so. The previous book covered a period of great organisational development, functional expansion and exploration of new avenues of audit. The chronological presentation was the best way to present it for proper evaluation and appreciation of the events and decisions. The present period largely represents the consolidation, expansion and refinement of what had already been started, the creation of a vast super structure for which the foundation already

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\* The author is former Principal Accountant General, Gujarat and former Member, Gujarat Electricity Regulatory Commission

existed. Therefore for this period, presenting the developments by themes, the areas which had crystallised as a result of past developments, was the most appropriate way.

The period from the years 1990 to 2008 covered by this book is undoubtedly an important period in the history of Indian Audit, just as it is an important period in the economic history of India. The decision of opening up the economy and subsequent movements of liberalisation and globalisation had invariable impact on every institution in the government and the Audit was no exception. The first and foremost development of this period is the emergence of Indian Audit in the International arena. The CAG was appointed a member of the Board of Audit of UN and later became the Chairman. He was equally active both in INTOSAI and ASOSAI and was also the auditor of a number of international organisations under the UN. Then there is the new area of information technology, which Indian auditors have taken like fish to the water and this period marks remarkable developments in this area. This period also witnessed the Audit taking up the new areas of privatisation, regulation and public-private partnership. There was also a vast consolidation in the infrastructure, training facilities and building of new professional institutions. All these developments have been brought out in great details in the book spanning over twenty two chapters in two volumes.

Before we discuss various aspects of style and presentation in this book, let us take a panoramic view of its contents. The first volume consists of nine chapters. It starts with the overview which very nicely summarises the developments surveyed by the author and also sums up the major developments in earlier years after the Independence. The next chapter dwells upon the developments in Government policies and public administration and their impact on CAG's audit and organisation. The author briefly discusses here the developments like the advent of computerisation and information technology in Public Sector and Government, the new constitutional status of the Panchayati Raj institutions, reforms and simplification of tax laws, privatisation and public private partnership, emergence of regulatory bodies and economic reforms in various sectors. Chapter 3 discusses the organisation of CAG, where all the developments in administration, staff matters, infrastructure and even AGs' Conference have been meticulously included with all the relevant documents. The next chapter is devoted to Developments in Auditing, which deals with the development of systems and procedures for the audit of expenditure along with the institutional changes adopted. This covers the Auditing Standards, audit planning, sampling techniques, risk based audit and other techniques along with institutional changes like engagement of consultants, peer review and Audit Advisory Board. This is followed by a chapter on Audit Reports (Civil) covering a discussion both on the Central as well as the State Audit Reports and also the position of deliberations in the PAC. Chapters 6 to 9 have been devoted to the discussion on the audit of other specialised areas like the audit of receipts, commercial audit, defence audit and the audit of post and telecommunication services. The author covers in these chapters the organisational arrangement for each of these audits, their mandate and special features, major developments during the period, focus of audit findings and the responsiveness of the Executive.

The second volume continues with the audit of specialised areas like Railway Audit and the audit of Scientific Departments for which chapters 10 and 11 are devoted. The focus thereafter shifts on the areas of audit where considerable developments have taken place during the last two decades as well on the emerging areas in Government Auditing. Thus Chapter 12 deals with performance audit, Chapter 13 with Audit of Autonomous Bodies, Chapter 14 with Audit of Local Bodies, Chapter 15 with the Emerging Audits and Chapter 16 with the computerisation in the Department and Audit of Information Technology. These chapters are really informative since they deal with the development of new audit areas, expanding the horizons of Audit. The performance audit which was already established in the Department since the early sixties has been now placed on a far more formal and structural framework, offering it a great and timely opportunity to grow in every area. The developments in the audit of local bodies recognise the growing importance of these bodies as agencies of development and the need for closer scrutiny in view of the large expenditure involved. The audit of local bodies is a new development where a collaborative concept of technical guidance and supervision has been adopted. Its implementation and success has to be watched with interest. In the emerging audits the author deals with the audit of regulatory bodies, audit of privatisation and the environment audit, giving in each area, the guidelines laid down, major audit findings, training arrangements and Audit Reports, if any.

Chapter 17 on Accounts deal with the new developments like Voucher Level Computerisation (VLC) at State Level and its benefits and developments in preparation of Accounts and their presentation and the new guidelines issued during this period. The next two chapters are on training and media policy and Chapter 17 deal with International Relations, which assumed centre stage during this period with Indian Audit becoming quite active in the International Audit arena. The author gives details of international activities and Indian contribution in various events. The next Chapter 21 deals with an important development of Regulations on Audit and Accounts, 2007 framed by the CAG. The author deals with the background and brief details of the Regulations. In the last Chapter 22 entitled 'Epilogue' the author discusses the challenges before the Department, strengths and weaknesses of IA&AD in the eyes of former C&AGs, Perceptions on Audit and the new developments in the Department which have not been covered elsewhere.

There are three Appendices at the end. Appendix A covers the instances of changes in policy, law, rules etc. by the Government at the instance of Audit. Appendix B gives brief details of 19 key case studies from Audit Reports and Appendix C gives the composition of Audit Advisory Board in the year 2007-08. In fact Appendix B is very informative and could have been a Chapter by itself.

It has been necessary to narrate the contents of the book in some detail, so as to enable us to appreciate the sweep of the various areas of working of the Department, which the author has covered in order to make this history meaningful as well as authentic. The long years of experience gained by Shri Vijay Kumar in practically every area of the Department coupled with his active participation in formulation of policies, have been a great asset for this remarkable work. The Department has co-operated so well

in furnishing all the facts and documents, but its thematic arrangements, structure and presentation of each of the chapters and the style and the language are those of the author. Utmost care has been taken by him to ensure that all the relevant material is collected and included and nothing of significance is left out. He undoubtedly deserves compliments for the rich contents of the book. Let us also remember that this is a factual history based on documents and the author was not expected give any opinions or evaluation nor should we expect the same. However for those who wish to evaluate the performance and actions of the CAG, his book provides very rich and crucial material.

The language of the book is simple and effective. The author has done well to avoid the officialese. Every major statement has been supported by the official document, which has been referred with sufficient details. The presentation has been equally good. As we have discussed above, the author has presented the history covering nineteen themes, devoting one chapter to each and three more chapters covering the overview, developments in government policies and their impact on the CAG's organisation and the epilogue. Each chapter has been structured very well, covers all the relevant facts and makes an independent reading in itself, presenting the selected theme in as much totality as the given facts would permit. The utility of each of the chapters has been further enhanced by the notes at the end of the chapter, which mention the sources relied upon, the list of key events in the developments pertaining to the theme and the Glossary of Abbreviation added at the end of each chapter. Important documents, which are crucial to the developments narrated in each chapter have been reproduced at the end of the chapter. This has made the book an indispensable guide for reference even for purely official work, particularly because of the authenticity of the documents, which have been provided by the Department and the facts also verified by them before the publication of this work.

It is interesting to see that in reproducing the various documents at the end of each chapter, the author has not been constrained by the period covered by the book. His objective has been to enable the reader to appreciate the theme in the best possible way. Thus the statement of the CAG on 22<sup>nd</sup> May, 1951 regarding the procedure followed for the preparation and submission of the Audit Reports to Parliament, a historical document in itself, has been reproduced as the document after Chapter 5. Similarly the statement made by the then CAG Narhari Rao on 13<sup>th</sup> December, 1952 at the meeting of the sub-committee on the "Exchequer Control over Public Expenditure", in which he described the "Private Ltd." companies formed under the Companies Act by the money drawn from the Consolidated Fund as "a fraud on the Companies Act", has also been reproduced as a document at the end of Chapter 7 on Commercial Audit. There are many such documents, which help the reader to appreciate the present developments in the light of the past. I can hardly resist the temptation to mention that at the end of Chapter 5 on Audit Reports (Civil), about 20 documents have been reproduced and I have found all of them very interesting and important. Among such fine reproduction of documents, one misses the important document like Regulation on Audit and Accounts, 2007. I wish it was included to make the work complete.

Above everything else, the book represents the gigantic effort by one of the oldest Departments in India to modernise itself, to suit the needs of time and to serve the people of India better. In this effort, we have thousands of people working in various offices across the country. When we say in this history that the CAG did such and such thing, it is symbolic, acknowledging his contribution as the leader. But credit equally belongs to all men and women, senior or junior, who worked together to make it possible. It is the outcome of their efforts which we see crystallised as the history in these pages. So it is indeed great that this history is now being recorded so well and available for the posterity. In future, it may be desirable to survey and include the developments in individual Audit as well as the Accounts offices, both at Central as well as State level. Let us not forget that a lot of innovation takes place in the field in the course of micro management of audits, which has a vital impact on the end result. Moreover State Units deserve that importance and it will be only proper that it is accorded to them. How and precisely in which way this can be done is a matter to be considered, but the history is certainly incomplete without that.

This history also touches an important aspect of transparency in Government. The entire book demystifies the working of the Audit Department, complete with all documents. The working of the Department, hitherto shrouded in a mystery is now like an open book. In my view therefore, the book is also an important contribution towards making the Department more transparent.

In the end, Shri Vijay Kumar deserves our compliments for giving us such a fine history. The Department also deserves to be commended for their thoughtful decision to bring out the history, right when the documents are available and those who took the decisions are available to explain them. It is indeed a useful work to all those interested in the cause of audit and is bound to generate a more meaningful and constructive discussion on the Audit and the Audit Reports.

## **SEMINARS AND ROUND TABLE DISCUSSIONS:**

### **Summary of discussions in the Round Table held on 28<sup>th</sup> July 2009 on “Outcome Budget”**

*(A list of participant is annexed)*

After the President had welcomed the participants to the Round Table and briefly introduced the subject, Dr. B.P.Mathur<sup>\*</sup>, who initiated the discussions as a lead speaker on the subject of ‘outcome budget’, made a comprehensive presentation on the background leading to introduction of outcome budget in 2005 as one of the first serious attempt to measure the results of Govt. spendings and performance. He pointed out that the Finance Minister in his budget speech of 2005 emphasized the need for putting in place a mechanism to measure the development outcome of all major programmes. He said the concept of outcome budget was basically a performance measurement tool to help in better service delivery, decision making, evaluating programme performance and results, etc. Outcome budget broadly indicates physical dimensions of the financial budget of the Government. Tracing the history of reforms measures taken in India, he stated that performance budget was introduced in 1969 on the recommendations of the First Administrative Reforms Commission to ascertain how much an organization had achieved compared to targets, and at what cost. Sadly with the passage of time, the performance budget became just an annual ritual. Another reform by the Government of India was the introduction in 1986 of the concept of zero based budgeting (ZBB) with the intention of judicious allocation of scarce resources so as to derive optimum benefits. ZBB was not very successful as the administrative ministries did not support it.

Speaking about outcome budget introduced in 2005, Dr. Mathur pointed out the following infirmities:

- Most Ministries were producing bulky documents full of statistics detailing budgetary outlays and targets, etc. of individual departments/units rather than macro performance of the Ministry;
- It (the outcome budget) did not talk about various important elements of performance viz., target vs achievement of rate of growth of the economy, employment generation, control of inflation, productivity of the economy, fiscal parameters such as level of public debt as percentage of GDP and fiscal deficit;
- There was no mention of the tax revenue i.e, direct and indirect taxes which were collected in relation to targets;
- There was no mention about curbing black money or bringing back illegal foreign exchange stashed abroad;
- At present each ministry/department gives its own claim regarding fulfillment of targets set in the outcome budget. According to Dr. Mathur,

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<sup>\*</sup> *Former Deputy Comptroller & Auditor General (Commercial) –cum- Chairman, Audit Board*



there is immediate need for an independent mechanism to verify whether the goals set by each Ministry/ department have been fulfilled.

- Most appalling is a total lack of accountability in the system. There is no system of penalty or punishment on public officials if the goals and targets set in the outcome budget are not fulfilled.

Dr. Mathur suggested that the concept of outcome budget should be redefined clearly indicating the vision of each organization, setting of clear measureable targets and outcomes. Every target, both long and short-term must be owned by the concerned officials either individually or collectively. There should be a rigorous performance monitoring and review system. There is a need for leadership playing a crucial role and top managers must lead by example.

As regards fundamental problems of budgeting in India, Dr. Mathur pointed out that system of annual budgeting leading to lapse of money at the end of fiscal year and resultant rush of expenditure in the month of march resulted in tremendous waste of public money. The present line form of budgeting implies that expenditure limits for every item is fixed and gives no flexibility to a particular department or field unit to spend money as per their priority, Ministries have little powers to re-appropriate funds from one head to another, due to centralised control of Finance Ministry, and therefore, administrative ministries are unable to make optimum utilization of money as per their best judgement. Other drawbacks include non-reflection of the share of capital expenditure in the amount of total expenditure incurred by the Government, effect of off-budget items like the oil bonds and fertilizer bonds on the extent of fiscal deficit is also not being reflected. The overall result is that the budget exercise in our Country is more of a ritual which does not attract any serious attention.

Dr. Mathur suggested that on the pattern of UK, the system of multi-year budgeting can be followed. He pointed out in this context the following main features of budgetary reforms in UK:

- Firm and fixed departmental expenditure limit plans are set for three years, which is controlled on yearly basis in comprehensive spending reviews;
- Public Service Agreements which are quasi-contracts are entered into between the Treasury and each departments about what they would deliver in return for budget funding;
- For better utilization of resources responsibility was shifted in 1982 to line-managers;
- Government departments were restructured in 1988 into Executive Agencies;
- Concept of Citizen Charter was introduced in 1991;
- All top posts were made contractual, thrown open for competition including to private sector.

Dr. Mathur concluded his presentation by stating that outcome budget was mostly an exercise in futility so far as there is no bar on Government's spending spree, lack of professionalism, accountability and commitment, etc.

A discussion of the issue involved followed where some of the individual participants expressed their views on the subject.

Shri Dharam Vir\* pointed out that the concept of performance budgeting or budgeting for performance had been there in our country since 1969 on the recommendations of first Administrative Reforms Commission. But as has been observed by Dr. Mathur it had become a sort of annual ritual not worthy of any serious note. On the output/outcome budget, he made following comments:

- The first outcome budget was presented in August 2005. In his forward speech, the Finance Minister listed various steps in the conversion of outlays into outcomes and outputs, namely standardizing unit cost of delivery , benchmarking the standards/ quality of outcomes/services, and involvement of the target group. But all these do not find a place in the latest revised guidelines for preparing the outcome budget 2009-10 issued by the Ministry of Finance in May 2009.
- Basically the primary purpose of outcome budget is to correlate the amount of expenditure with the results in consequence of such expenditure. But as has been pointed out in the CAG's Audit Report on Accounts of the Union Government, in the case of various flagship schemes the amount of actual expenditure could not be ascertained because of the amounts lying with the implementing agencies to which central funds had been directly transferred bypassing the State Government.
- The aspect of outcome budget namely achievement has been equally problematic since no information is available whether any credible measures of outcome, as distinguished from outputs, have been evolved.
- The figures of outputs are suspect because of deficiencies and defaults in reporting mechanism with no effective system of data audit.
- Output/outcome budget is an instrument of accountability intended to hold Government accountable for the use of the money voted by the legislature and spent by the Government functionaries. However, there are too many jurisdictions (State Governments, Urban Local Bodies, and Panchayat Raj Institutions) and agencies involved in programme implementation and their inter se accountability obligations are not always rigorously determined with the result that nobody can be held accountable for poor performance.
- As regards the presentation of output/outcome budget with financial budget there are certain inherent constraints. The budget is constructed by a combination of bottom up and top down approach with the result that the final amount of funds provided in the budget becomes available only on the eve of presentation of the annual financial budget to the Parliament. This may not leave enough time for the conversion of outlays into outcomes and outputs for the presentation of the output/outcome budget with the financial budget. Though the intention of the Government is to make output/outcome budget as an integral part of the main budget, in practice it would be enough if the outcome/output budget could be presented in time for examination of the Demands for Grants by the Departmentally Related Standing Committees of the Parliament.

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\* Former Deputy Comptroller & Auditor General of India

- Dr. Mathur has rightly referred to the effect of off-budget items like the oil bonds and fertilizer bonds on the extent of fiscal deficit. The CAG has already expressed concern over this and this has also been mentioned in the Audit Report. But an equally important area for audit investigation would be the veracity of the amounts for which bonds have been issued. A few months ago there were reports in the media that the Cabinet Secretary had been asked to look into this. The amount of bonds represents the extent of under-recovery of costs. But the costs could be exaggerated. The IAAD is in the unique position of having access to records of Government as well as the oil PSUs. It may therefore be worthwhile to undertake an examination of the determination of the costs of production of oil products like petrol, diesel gas, and kerosene to see that these are correctly computed and there are no exaggerations in the amounts of under-recoveries and the bonds issued.
- The point made by Dr. Mathur about the share of capital expenditure in the amount of total expenditure is also well taken. But what is capital expenditure? The Constitution of India which provides the institutional framework for presentation of budget recognizes two types of expenditure: expenditure on revenue account and other expenditure. The expression capital expenditure is defined only in the General Financial Rules. Capital expenditure is defined as any significant amount of expenditure incurred with the object of acquiring assets of a permanent nature or enhancing the utility of the existing assets. But a critical factor is the ownership of assets. Thus any amount of expenditure incurred direct by the Government for construction of school buildings or on rural roads would qualify as capital expenditure but the same amount paid to extra-Government agencies like registered societies or Panchayati Raj Institutions for the same purpose would show up in Government accounts as revenue expenditure since in the latter case the ownership of assets does not vest in Government. Nowadays large amounts of expenditure are incurred on capital works by release of grants to such extra-Government agencies. It would be desirable to keep this aspect in view while discussing the share of capital expenditure in the total expenditure of the Government.

Shri M.P Gupta<sup>\*</sup>, while sharing the views expressed by Dr. Mathur and others, stated that we need not get dejected as we are moving forward and there are lot of good things in the system. He gave the example of Accounting format for Pradhan Mantri Sadak Nirman Yojana which were developed by the IPAI and which captures full information on the status of financial and physical progress in the construction of roads, works completed with their specific location. In other words the focus of developing the accounting system was not only to give the information relating to outlays and expenditure but also linking budgetary allocations with outcomes. He also pointed out that all this information is available on the website to every citizen.

Shri B.B.Pandit<sup>\*</sup> stated that the presentation made by Dr. Mathur was thought provoking and from his experience of budget preparation of a Urban Local Body, while on deputation, he had observed that new services and projects were being included in the budget even before a preliminary assessment of their feasibility and

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<sup>\*</sup>Former Additional Secretary (Expenditure), Government of India

<sup>\*</sup>Director General (Audit), O/O the Comptroller & Auditor General of India, New Delhi

the real magnitude of required allocations. This practice, apparently adopted from the Central government departments resulted in poor quality of budgeting in which new proposals were being incorporated in the budget under various kinds of pressure, without adequate ground work and without crossing an assessment threshold. This situation virtually has given rise to the phenomenon of budgeting by announcements on the part of political executive a practice of which the second Administrative Reforms Commission in its report on Public Financial Management had taken a dim view. Shri Pandit wonders how outcome budgeting was ever possible under such circumstances.

Shri S. Krishnan<sup>\*</sup> was of the view that large funds of Government of India were spent through Autonomous Bodies, NGOs, Societies. These bodies received grants from Government of India. He wondered whether Government had any mechanism in place to monitor the expenditure by these bodies and to ensure that the funds were utilized for the purpose for which they were provided.

Shri Dharendra Krishna<sup>\*</sup> was of the view that the presentation by Dr. Mathur and subsequent discussions showed that zero-based budgeting, performance budgeting and outcome budget were only cosmetic exercises, that did not result in effective public accountability of the executive to the citizens. Budgets only facilitate administrative control of higher administrative echelon over subordinate offices. It appeared that budgets are ‘of the officers, by the officers and for the officers’, instead of being an effective instrument of democratic public accountability. He was of the view that centralized public accountability did not serve the intended purpose and therefore, it was necessary to consider some other options like implementation of concept of outcome budgets and concept of social audit incorporated in NREGA in letter and spirit, access to public records to Citizens under RTI Act, etc.

Shri P.K.Brahma<sup>♥</sup> stated that while it is true that the annual budget exercise i.e budget formulation, its implementation and monitoring continue to remain annual rituals and consequently the outcome budget was mostly a non-starter, one need not take a pessimistic view of the situation. There are silver linings which should make us optimistic about the possibility of a meaningful outcome budget process, for example, in the 11<sup>th</sup> Five Year Plan, the Government has pronounced that “Inclusive Growth” will be the main theme, strategy and vision of the future years and accordingly, the planning Commission has formulated 27 monitorable national targets covering income & poverty, education, health, employment, etc. for achieving the objectives of inclusive growth. Close monitoring of these 27 national targets implementable through specific schemes/ programmes like NREGA would certainly be reflected in the future outcome budgets. He stressed the need that Seminars like this organized by IPAI should come out with positive suggestions/ recommendations. He gave the following suggestions/ recommendations for consideration of the Institute:

- Plan budget allotted to the Ministries to implement the key schemes and programmes should not automatically lapse at the end of the financial year. A mechanism needs to be adopted for uninterrupted and need-based flow of funds for smooth implementation of the projects and schemes.

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<sup>\*</sup> *Former Member (Finance) Postal Board, Ministry of Communications*

<sup>\*</sup> *Former Executive Director(Finance) BHEL*

<sup>♥</sup> *Former Deputy Comptroller & Auditor General of India*

- There should be separate budgets for the vital Ministries and economic Ministries (idea also mooted by Shri Sharad Pawar, Agriculture Minister in the Government of India) on the pattern of Railway budget for fast track growth.
- Separate MOUs should be drawn up and signed between the Government and the key and Economic Ministries, on the pattern of the systems prevailing in Newzeland, Australia, UK with the aim of achieving greater speed in the delivery systems, greater efficiency and better performance and accountability.

The President complimented Dr. B.P.Mathur for a very comprehensive presentation covering various important issues on the subject. The discussions and observations by the participants further brought out many significant suggestions and improvements that were needed to make the outcome budget a valuable document that could be a source of not only adequate and transparent information, but more important, a great help for policy corrections and improvements.

**Round Table Discussion on the concept of ‘Outcome Budget’ by the Government of India held on 28<sup>th</sup> July 2009**

**List of Participants**

Shri Vijay Kumar, President, IPAI, conducted the proceedings as the Convener of the Round Table.

<b>Sl. No.</b>	<b>Participants (S/ Shri)</b>
1.	Dr. B.P. Mathur
2.	B.B. Pandit
3.	Bhajan Singh
4.	Dharam Vir
5.	Dhirendra Krishna
6.	Harish Chander
7.	K.L. Kapoor
8.	K.N. Khandelwal
9.	M.K. Jain
10.	M.P. Gupta
11.	Prof. Nand Dhamija, IIPA
12.	P.K. Brahma
13.	Rajeshwar Prasad
14.	Ms. R. Rajlakshmi
15.	R.M. Nawani
16.	S. Krishnan
17.	T.L. Gupta
18.	Prof. V.N. Alok, IIPA
19.	Vikram Chandra

## **Summary of the Proceedings of the Seminar on Governance and Accountability by IPAI (2<sup>nd</sup> May 2009)**

The seminar was chaired by Prof. Venkatesh Athreya of Bharathi Dasan University. Introducing the theme of the seminar, Mr. T.S. Kannan, President of the Tamil Nadu Chapter stated that after the Institute held its first seminar on emerging concerns about Public Accountability in 2006, there has been a very significant and welcome growth of studies about the delivery of Public Services. The increasing participation/ association of beneficiaries and the recognition of audit should go beyond regulatory checks have helped in the wider dissemination of information leading to greater recognition of Rights of Beneficiaries. Significantly the nature of discourse has changed. The citizen is not merely a dole receiver in cash or kind but a partner. At the same time there are no visible signs of the Rulers and their Servants making any effort to follow up findings of studies and reports. The record of legislative structures engaging with people in remedying the deficiencies is very poor. With ever increasing dependence on the State and large organizations to access essential services and growth of control on monetary resources by the chosen elite, the poor have no recourse to the “empowerment” said to have been acquired except by way of organized public struggles. Citizen or Public Audit must expand and extend to all areas of activities that use public funds. Recent developments in the business world reinforce this demand, he said.

In his presidential address Prof. Venkatesh Athreya stated that with liberalization, globalization and privatization the Government had abdicated its responsibility and avoided social cost to a large extent. He felt that Accountability needed a wider dimension – participation initially and the accountability later. He agreed with the view that creation of awareness among the community in participation, local planning, promoting collective decision and encouraging local democracy would help accountability in governance. He suggested that IPAI should form a core group to fix norms for governance and mooted an idea of organizing Audit Literacy Programme ad net working process with other organizations could also be considered in this regard. He stressed the need for both public accountability and private accountability.

In his presentation, Mr. T. Sethumadhavan, IA&AS, Vice-President of the Institute stated that the recent experience regarding responsiveness to Audit Reports at the Centre/ State levels had been very poor and the impact of public audit on the Executive was discouraging. The available statistical information regarding the responses to audit findings, included in the Audit Reports/ Performance Reports are testimony of the apathy of Executive to public audit. The working of the Public Accounts Committee (PAC) and the Committee on Public Undertakings (COPU) at the Centre as well as in States is not tuned to play an effective role in the processing and follow up of Audit Reports. The recommendations of Shakder Committee which went into the issue did not seem to have made any impact. Considering that Audit Reports reflect only a fraction of the actual audit efforts, the true situation as regards response to public audit is worse than what it represents. The provisions in the Right

to Information Act (RTI) regarding social audit could be exploited to create such awareness. He also added that the Institute of Public Auditors of India had made certain recommendations to the Second Administrative Reforms Commission about enhancing the effectiveness of public audit by introducing a National Audit Act, providing for auditors interacting with peoples representatives directly.

In the back drop of the experience in implementation of the Sarva Shiksha Abhiyan (SSA) by the Governments, Mr. K. Ramachandran underscored the need for social book keeping and social accounting and course corrections. He was of the view that social audit created awareness among the stake holders and the social service providers and would train the community in participation, local planning, promoting collective decision, strengthening transparency and accountability to narrow the gap between vision and the realities on the ground. Pointing out the many loopholes in the SSA system he said that the rules were elaborate, but there were no safeguards.

Dr. Vinod Vyasalu, Director for Budget Policy and Research, Bangalore expressed the view that the question of participation and accountability applied to all projects. Many do not take local government seriously in India. It is often considered corrupt. Often, 'people's participation' is pitted against local government. This is something that must change. Local government is the first tier of democracy. Without local government participation, there is no likelihood of any meaningful people's participation. Of course, the converse may not be true. These concerns relate to the preparation and design of projects. Audit can then be against these benchmarks. Today audit is often like a post mortem and this attitude must change, he said. Pointing out that the management of a number of corporate institutions with uncontrolled command of resources is failing not only financially but more significantly in meeting minimum standards of ethics, causing immeasurable hardship to large number of small share holders was sufficient proof that one should look beyond the certificates and reports of auditors.

Mr. R. Sekhar, a practicing Chartered Accountant spoke on corporate governance. He highlighted the gaps and confusions in enactments and in enforcements of provisions of Act and Accounting Standards. Quoting cases from a number of corporates he pointed out that an unethical practice was going on in India and the small shareholders were often taken for a ride. He also stressed the need for auditors assuming greater responsibilities in the discharge of their duties.

Narrating various aspects of governance in Urban Development Planning for sustainable living Mr. N.G. Devasahayam, IAS, Managing Trustee, SUSTAIN said that in the present day context of decaying governance delivery and management of public services were essential tools of urban development planning.

The following views and suggestions were expressed in open house discussion:

- Public audit by C&AG must be strengthened and given teeth



- The term “public” should be redefined to include participation not only by governments, but also the general public
- Election donations should not be made in cash and spending should be subjected to public audit
- The audit reports should be made available to the general public
- MLA and MP Area Development Fund should be scrapped
- Awareness of Accountability should be created
- IPAI to promote an Audit Literacy Campaign
- Media should not confine to sensational news alone, but bring out cases of lack of governance and public accountability
- Reforms in the right direction are the need of the hour
- Government in power should publish periodically the progress of implementation of common minimum programmes announced before elections
- A new mindset and more structural reforms are the need of the hour.

**Conclusion:** The IPAI seminar seeks a broad consensus on:

- The need for expanding public/ citizen audit
- The need for civil society engagement in Economic Policy making and budgeting
- Defining the objectives of social audit programmes to align them with the basic rights of people to freedom and productive livelihood.
- The command of resources by large corporate bodies and the unfortunate transfer, nay abdication of, state responsibilities and duties in their favour pose a challenge and these organizations should come under the programme of Citizen Audit.
- Mobilization of support from people/ institutions and more particularly academic bodies, seeking the active involvement of professional organizations and the Parliamentary Committees.

## **DOCUMENTS:**

### **Fourteenth Report: Second Administrative Reforms Commission – Strengthening Financial Management System – Excerpts from Summary of Recommendations**

- 1. (Para 4.5.8) Unrealistic Budget Estimates**
  - a. The assumptions made while formulating estimates must be realistic. At the end of each year the reasons for the gap between the ‘estimates’ and ‘actuals’ must be ascertained and efforts made to minimize them. These assumptions should also be subject to audit.
  - b. The method of formulation of the annual budget by getting details from different organizations/units/agencies and fitting them into a predetermined aggregate amount leads to unrealistic budget estimates. This method should be given up along with the method of budgeting on the basis of ‘analysis of trends’. This should be replaced by a ‘top-down’ method by indicating aggregate limits to expenditure to each organization/agency.
  - c. Internal capacity for making realistic estimates needs to be developed.
  
- 2. (Para 4.6.5) Delay in Implementation of Projects**
  - a. Projects and schemes should be included in the budget only after detailed consideration. The norms for formulating the budget should be strictly adhered to in order to avoid making token provisions and spreading resources thinly over a large number of projects/schemes.
  
- 3. (Para 4.7.8) Skewed Expenditure Pattern – Rush of Expenditure towards the end of the Financial Year**
  - a. The Modified Cash Management System should be strictly adhered. This System should be extended to all Demands for Grants as soon as possible.
  
- 4. (Para 4.8.26) Inadequate Adherence to the Multi-year Perspective and Missing Line of Sight between Plan and Budget**
  - a. A High Powered Committee may be constituted to examine and recommend on the need and ways for having medium-term expenditure limits for Ministries/Departments through the Five Year Plans and linking them to annual budgets with carry forward facility.
  - b. In order to bring about clarity, transparency and consolidation, the ways and means for implementing an ‘alignment’ project, similar to that in the UK, may also be examined by the High Powered Committee so constituted.

5. **(Para 4.11.2) Adhoc Project Announcements**
  - a. The practice of announcing projects and schemes on an ad-hoc basis in budgets and on important National Days, and during visits of dignitaries/ functionaries to States needs to be stopped. Projects/schemes which are considered absolutely essential may be considered in the annual plans or at the time of mid-term appraisal.
  
6. **(Para 4.12.6) Emphasis on Meeting Budgetary Financial Targets rather than on Outputs and Outcomes**
  - a. Outcome budgeting is a complex process and a number of steps are involved before it can be attempted with any degree of usefulness. A beginning may be made with proper preparation and training in case of the Flagship Schemes and certain national priorities.
  
7. **(Para 4.13.4) Irrational 'Plan – Non Plan' Distinction leads to Inefficiency in resource Utilization**
  - a. The Plan versus non-Plan distinction needs to be done away with.
  
8. **(Para 5.2.12) Flow of Funds relating to Centrally Sponsored Schemes**
  - a. The Controller General of Accounts, in consultation with the C&AG, should lay down the principles for implementing the system of flow of sanctions/ approvals from the Union Ministries/Departments to implementing agencies in the States to facilitate release of fund at the time of payment. After taking into account the available technology and infrastructure for electronic flow of information and funds, especially under the NeGP, and putting in place a new Chart of Accounts, the scheme should be implemented in a time bound manner.
  
9. (Para 5.3.6) Development of Financial Information System, a. A robust financial information system, on the lines of SIAFI of Brazil, needs to be created in the government in a time bound manner. This system should also make accessible to the public, real time data on government expenditure at all levels.
  
10. **(Para 5.4.3) Capacity Building**
  - a. The capacity of individuals and institutions in government needs to be improved in order to implement reforms in financial management. To facilitate this, a proper programme of training needs to be devised and implemented in a time bound manner.

**11. (Para 6.3) Accrual System of Accounting**

- a. A Task Force should be set up to examine the costs and benefits of introducing the accrual system of accounting. This Task Force should also examine its applicability in case of the Appropriation Accounts and Finance Accounts.
- b. Initially, a few departments/organizations may be identified where tangible benefits could be shown to be derived within 2-3 years by implementing the accrual system of accounting, especially departmental 'commercial undertakings'.
- c. The result of this initial implementation may be studied by a committee of experts which would recommend on its further implementation in all departments/organisations at the Union/State level along with exclusions, if any. This may proceed in a phased manner.
- d. Prior to its implementation, training and capacity building needs of the accounting personnel and all stake holders in the decision making process would have to be addressed and a meticulous schedule worked out in line with the road map of implementation.
- e. Before the new system is adopted, alignment of the plan, budget and accounts, as recommended in this Report elsewhere, needs to be achieved and a viable financial information system needs to be put in place.

**12. (Para 7.5) Internal Audit**

- a. An Office of the Chief Internal Auditor (CIA) should be established in select Ministries/departments to carry out the functions related to internal audit. Its independence, duties, functions, mechanism of coordination with the CAG etc. should be provided by a statute.
- b. CIAs should be directly responsible to the Secretary of the Department.
- c. In the initial stages, personnel may be inducted from existing accounts cadres. Norms for recruitment and utilizing private sector expertise in select tasks may also be devised. Capacity building needs for proper functioning of this Office should be identified in advance.
- d. The modalities for ensuring non-duplication of work vis-à-vis the C&AG should be formalized. This should be aimed at assisting the C&AG in concentrating on carrying out specialized audit/tasks.
- e. Standards for internal audit should be prescribed by the Office of the C&AG.
- f. The Accounting functions should be completely separated from Internal Audit.

- g. The functioning and effectiveness of this new system may be examined after allowing a suitable period of operation. Based on the results of this examination, such offices may also be instituted in other Ministries/ departments/organisations.
- h. An Audit Committee should be constituted in each inistry/Department. It should consist of a Chairperson and two members to be appointed by the Minister in charge of that Ministry/Department. The Chairperson should be a person of eminence in public life. The two members should be from outside the government. The Audit Committee should look after matters related to both internal and external audit including implementation of their recommendations and report annually to the respective Departmentally related Standing Committee of Parliament.

**13. (Para 7.6.5) Integrated Financial Adviser**

- a. The role of the Financial Adviser as the Chief Finance Officer of the Ministry who is responsible and accountable to the Secretary of the Ministry/ Department should be recognized and the trend of dual accountability should be done away with.
- b. Officers with sufficient training and experience in modern financial management systems should be posted as Financial Advisers in the Ministries/Departments.

14. (Para 8.8.7) Accountability to Parliament a. In order to further strengthen the Parliamentary oversight mechanism, as many audit paras as possible need to be examined by Parliamentary Committees. To facilitate this, the PAC and COPU may decide in the beginning of the year itself, which paras would be examined by them and which by their sub-committees (to be constituted for the purpose). They may consider assigning other paras to the respective Departmentally related Standing Committees. The objective would be to complete the examination of all paras within one year. In exceptional cases, Chairman, PAC/COPU may authorize keeping a para alive for more than one year. If still some paras are pending, it is for the consideration of the PAC and COPU to refer these to the Departmental Audit Committees (recommended vide paragraph 7.5 of this Report).

**15. (Para 8.9.7) Relationship between Audit and the Government/Government Agencies**

- a. There is need for better understanding and synergy between the audit and auditees for enhanced public accountability and consequently better audit impact.
- b. There should be balanced reporting by the audit. Audit reports should not focus on criticism alone but contain a fair assessment or evaluation, which would mean that good performance is also acknowledged.
- c. There is need for increasing interaction as well as coordination between the executive and the audit, including at senior levels. These

should include regular and meaningful meetings where important issues could be discussed and conclusions reached on what needs to be done arising out of the recommendations made by the audit. There should also be quarterly communication from the Accountant General to Administrative Secretaries informing them about significant points and areas of improvement noted by Audit during their inspections.

**16. (Para 8.10.4) Timeliness of Audit**

- a. External audit needs to be more timely in inspecting and reporting so that their reports can be used for timely corrective action. All audits for the year under review should be completed by 30th of September of the following year. To start with, all Audit Reports may be finalized by 31<sup>st</sup> December and this date may be gradually advanced.
- b. IT should be used increasingly and effectively for data collection and analysis.
- c. Government agencies also need to be more prompt in responding to audit observations and ensure that the remedial and corrective action not only settles the irregularities reported but also addresses the systemic deficiencies.

**17. (Para 8.11.5) Inadequate Response to Audit**

- a. The pending audit paras should be monitored by having a database on them in each Ministry/Department. In case of persistent default in submitting replies to the audit paras a procedure should be laid down for action against the concerned officer.

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