

AUDIT OF PUBLIC SECTOR UNDERTAKINGS

(CA Final)

Introduction: Public sector enterprises are organised through any one of the following modes:

- Departmentally managed undertakings which form part and parcel of Government activities, for example Indian Railways, Security Printing Press, Postal Services, Canteen Stores Department ;
- Government companies and deemed Government companies set up under the Companies Act 1956, where Government or Government-owned and controlled Institutions own 51 % or more of the paid up capital;
- Corporations set up under the specific Acts of legislature e.g., Life Insurance Corporation, Unit Trust of India, etc.

In India, government audit is performed by the Comptroller and Audit General of India (C&AG), through the Indian Audit and Accounts Department.

Objective and Scope of Public Enterprises Audit: the scope and extent of public enterprises audit is determined by the Comptroller and Auditor General. Public sector undertakings have a high degree of public accountability. Hence audit of public enterprises is not restricted to financial and compliance audit; it also extends to efficiency, economy and effectiveness audit. Another aspect of audit relates to questions of propriety; this audit is directed towards an examination of management decisions in sales, purchases, contracts, etc. to see whether these have been taken in the best interests of the undertaking and conform to accepted principles of financial propriety. Thus we can say that, the scope of public enterprise audit not only includes the scope of statutory audits but also extends to ensure the proper accountability, and the efficiency and effectiveness of its operations.

Difference between Statutory Audit & Public Sector undertaking audit

	Statutory Audit	Public Sector Undertaking Audit
Scope	The scope of statutory audit is defined by the statute under which the auditor is appointed, e.g. Section 227(1A)(3)(4)(4A) of the Companies Act	The Scope and extent of Public Sector Undertaking is determined by the C&AG, in addition to the general stipulation of the governing statute.
Appointment	The auditors are appointed by the company, either through its members at	The auditors are appointed by the C&AG

	Annual General Meeting or by the Board.	
Supplementary/test audit	The Act does not empower to conduct any supplementary or test audit for non-government companies	C&AG is empowered to conduct supplementary or test audit for PSU's or Government Companies
Principles	The statutory auditor conducts the audit within the framework of the Companies Act, General financial and commercial audit principles & procedures are adopted.	Public Sector auditor adopt certain techniques of government audit
Direction by C&AG	The act does not prescribe the procedures that should be followed for examination of the books of accounts or verification of assets & liabilities	C&AG issue directions to the statutory auditor to report on, in addition to the general aspects of audit covered by the statutory auditor.
Propriety	The statutory auditor is not concerned with propriety, efficiency and effectiveness of transactions. (Except for specific cases u/s 227(1A) or (4A))	Audit of Public Sector Undertaking covers (1) Financial accounts (2) Compliance with procedures, rules & orders (3) Efficiency, Economy & Effectiveness (4) Propriety, and (5) Examination of management decisions.

Audit of Government Companies [Section 619 of the Companies Act, 1956]: Statutory auditors of Government Company are appointed or re-appointed by the Comptroller and Auditor General of India (C & AG). The C&AG has the following power under the Companies Act, 1956:

- Power to issue directions [Section 619(3)]: The C&AG has the power to direct the manner in which the accounts of company shall be audited and to give the auditor the instructions in regard to any matter relating to the performance of his functions. The C&AG has issued directions through a special questionnaire to be answered by the statutory auditor in addition to his report u/s 227 of the Act.
- Power to conduct supplementary audit [Section 619(4)]: The C&AG is empowered to conduct a supplementary or test audit in addition to the regular statutory audit. He is also empowered to comment upon or supplement the report submitted by the statutory auditors. Any such comments upon, or supplement to, the audit report shall be placed before

the annual general meeting of the company at the same time and in the same manner as the statutory audit report. The C&AG can also authorize such person as he deems fit for such audit and require the information to be furnished to such authorized person in such form as the C&AG may direct for the purpose of such audit.

- Section 217(3) of the Companies Act, 1956 imposes a duty on the Board of Directors of a company to give the fullest information and explanations in the Directors' Report regarding every reservation, qualification or adverse remarks contained in the auditors' report. In the absence of similar provisions requiring the company to give their reply on the reservations made by the C & AG, the board of directors of such a company is not bound to give information or explanation in respect of such comments.

Comprehensive Audit of Public Enterprises: Public enterprises have been set up with socio-economic objectives. Comprehensive audit involves assessing efficiency and effectiveness of public enterprises. The efficiency and effectiveness audit of public enterprises is conducted on the basis of certain standards and criteria. The starting point of a comprehensive audit of a public enterprise is the preparation of an audit programme based on the study of decisions relating to the setting up of the enterprise, its objectives, the areas of operation, organisation, financial and operational details available in the annual reports and accounts budgets and other relevant documents.

The areas covered by comprehensive audit are:

- Investment decisions, project formulation and management,
- Delegation of powers and management information systems,
- Organizational effectiveness, capacity utilization, management of equipment, plant and machinery,
- Production performance, productivity of labour, materials management,
- Sales and credit control, budgetary and internal control systems, etc.

The areas covered in comprehensive audit will naturally vary from enterprise to enterprise depending on the nature of the enterprise, its objectives and operations.

Some of the issues examined in comprehensive audit are:

- Comparison of overall capital cost of the project with the approved planned costs.
- Achievement of Production or operational outputs vis-à-vis under-utilization of the installed capacity
- Achievement of planned rate of return

- Does the enterprises have Research and development programmes.
- Adequacy and efficiencies of purchase policies, cost control measures etc.

Committee on Public Undertakings (CPU): Due to growing number of public sector enterprises, the parliament decided to setup a separate committee on public sector undertaking so that their operations could be monitored closely. The function of the Estimates Committee and the public Accounts Committee were to be handed over to this new committee. Thus the Committee on public undertaking was setup under the rules of Lok Sabha. The newly setup committee took over the functions of the Public Accounts Committee and the Estimates Committee. The functions of the Committee are -

- to examine the reports and accounts of public undertakings.
- to examine the reports of the C&AG on public undertakings.
- to examine the efficiency of public undertakings and to see whether they are being managed in accordance with sound business principles and prudent commercial practices.

The Financial Committees present their Report to the Parliament/ State Legislature with their observations and recommendations.

Propriety Audit: Propriety audit stands for verification of transactions on the tests of public interest, commonly accepted customs and standards of conduct. Instead of too much dependence on documents, vouchers and evidence, it shifts the emphasis to the substance of transactions and looks into the appropriateness thereof on a consideration of financial prudence, public interest and prevention of wasteful expenditure. Thus, propriety audit is concerned with scrutiny of executive actions and decisions bearing on financial and profit and loss situation of the company, with special regard to public interest and commonly accepted customs and standards of conduct.

General principles relating to propriety aspect are:

- that the expenditure is not prima facie more than the occasion demands and that every officer is expected to exercise the same degree of vigilance in respect of expenditure as a person of ordinary prudence would exercise in respect of his own money in similar circumstances.
- that no authority should exercise its sanctioning powers for its own advantage (both direct or indirect);
- that funds should not be utilised for the benefit of a particular person or group of persons and
- that, apart from the agreed remuneration or reward, no other avenue is kept open to indirectly benefit the management personnel, employees and others.

Relevant provisions in the Companies Act, 1956 having direct or indirect bearing on propriety concepts are:

- Section 209(1) (d) relating to Cost Accounting Records.
- Section 227(1A) requiring enquiry into certain specified matters like loans & advances
- Section 227(4A) requiring a supplementary statement on matters specified in the CARO.
- Section 233B relating to requirements of Cost Audit.
- Section 619(3) (a) requiring a supplementary statement in respect of the Government companies on specified matters.
- Director's Report: information regarding energy conservation measures, Responsibility statements etc.
- Additional information in Schedule VI, Part II.

Area of Propriety Audit u/s 227(1A) of the Companies Act, 1956: The following matters of inquiry u/s 227(1A) involve propriety elements:

- Whether, loans and advances made by the company on the basis of security are properly secured, and whether the terms of security on which they have been made are not prejudicial to the interests of the company or its members.
- Whether, transactions of the company which are represented merely by Book Entries are not prejudicial to the interests of the company.
- Whether, investments of companies other than Investment Company or Banking Company have been sold at a price less than the purchase price.
- Whether, personal expenses have been charged to revenue account.

Area of Propriety Audit u/s 227(4A) of the Companies Act, 1956 [CARO, 2003]: The following matters contained in CARO involve enquiry based on propriety:

Clause	Items covered	Clause	Items covered
4(iii)	Loans to / from Directors and Interested Parties	4(xii)	Loan against Securities
4(iv)	Internal Control	4(xv)	Guarantees Given
4(v)	Transactions covered by Section 301 of Companies Act	4(xvi)	End-use of Borrowings
4(ix)	Statutory Dues	4(xvii)	Application of Funds
4(xi)	Repayment of Dues	4(xx)	End-use of Issue Proceeds
4(xxi)	Fraud		

Note: Refer Chapter - Audit Report for reporting requirements on the above clauses.

Problems in Propriety Audit: Problems in propriety audit arise mainly because of its distinct nature. Some problems are given below:

- The expression "propriety" is a moral term and can be understood by reference to the concept of morality accepted by the society at a given time.
- In any auditing, the essential test lies in formulation of auditing propositions. In the audit of financial accounts by reference to financial and legal requirements, propositions are built up about happening of events, existence, accuracy, title, ownership, compliance with law and internal regulations etc., which are all verifiable. In propriety audit, it is difficult to formulate verifiable audit propositions.
- Propriety audit has an inherent element of subjectivity because it is very difficult to establish standards of public interest, commonly accepted customs, standards for conduct which are not firm basis for audit evaluation.
- C&AG has developed the norms of propriety for Government expenditure. It may not apply to transactions of private sector. Each private sector entity has its own unique propriety norms.
- The norms are applied often too mechanically and create problems for expeditious and efficient working. In private sector, this attitude may prove counter-productive.

Performance Audit: A performance audit is an objective and systematic examination of evidence for the purpose of providing an independent assessment of the performance of a government organization, program, activity, or function. The objective of performance audit is to evaluate economy, efficiency and effectiveness of entity's policy, programme, organization and management. Performance audits include economy & efficiency audit and program audits.

- Economy and efficiency audits include determining (1) whether the entity is acquiring, protecting and using its resources (such as personnel, property, and space) economically and efficiently, (2) the causes of inefficiencies or uneconomical practices, and (3) whether the entity has complied with laws and regulations on matters of economy and efficiency.
- Program audits include determining (1) the extent to which the desired results or benefits established by the legislature or other authorizing body are being achieved, (2) the effectiveness of organizations, programs, activities, or functions, and (3) whether the entity has complied with significant laws and regulations applicable to the program.

Annexure I

Specimen Performance Audit Report issued by the Comptroller and Auditor General of India

[Source: www.cag.gov.in]

Electronics Corporation of India Limited

Computer Education Division

Electronics Corporation of India Limited started the business of computer education without conducting any objective and detailed assessment of the business potential or its own strengths and weaknesses. The Company did not formulate any policy with regard to appointment of franchisees and as a result faced problems in implementing the franchisee agreements. It had to cancel as many as 63 franchisee agreements during the first 5 years of operation ending March 2005. There was lack of effective internal control due to which the franchisees worked on their own and exploited the name and repute of the Company. In one agreement alone, the Company had to suffer a loss of Rs 67.13 lakh during 2001-02 and 2002-03. The Company also undertook school projects in different States wherein too, it worked through the franchisees. Due to problems in controlling the functioning of these franchisees, the Company had to take a decision to not undertake such projects in future. The Company failed to achieve the target turnover and also suffered losses during the years 2001-02, 2002-03 and 2004-05 in this business segment.

Air India Limited

Fleet Utilisation and Maintenance

Air India Limited had a fleet of 36 aircraft as on 31 March 2005, out of which 18 were owned by the Company and remaining were on dry lease. No aircraft was purchased after 1996. The Company resorted to taking aircraft on dry lease for augmentation of fleet since the year 2000 due to absence of an effective fleet replacement policy.

The Company cancelled/rescheduled the flights in 3.05 to 12.04 % cases and delayed it by more than 20 minutes in 17.35 to 21.87 % cases during the last three years ended 2004-05, but it did not maintain the industry data in regard to adherence to flight schedules for evaluation of its own performance vis a vis the other airlines. The utilisation of the available fleet, however, was more than the industry average as well as the planned hours in most cases.